UNDERSTANDING YOUR COOPERATIVES

UNITED STATES
DEPARTMENT OF
AGRICULTURE

ECONOMICS,
STATISTICS, AND
COOPERATIVES SERVICE

COOPERATIVE
INFORMATION
REPORT 6

Foreword

Cooperative leaders, many of whom are engaged in cooperative education and personnel employment and training activities asked Economics, Statistics, and Cooperatives Service (ESCS) to prepare an instructional series on cooperatives. The series was to be designed for post-secondary schools to improve student understanding of cooperatives operating in the community. These leaders were especially interested in technical schools and institutes and community and junior colleges.

Most post-secondary schools and colleges have cooperative education programs where many of their students enter into a cooperative work program between the school or college and the business community. The student is able to study and work at the same time.

Post-secondary instructors and administrators were consulted on the need for general cooperative instruction, preparing students to make more effective use of rural cooperative work opportunities. They have expressed a continuing interest in and a desire for suitable cooperative teaching material to supplement existing general economics, business, social studies, agricultural, or other courses. Those consulted stipulated keeping the program basic and that it be divided into four areas: cooperative business organization, history, people involved, and finance and taxation.

Numerous visual aids are included for easy reproduction as transparencies to assist instructors. These same visuals, along with cooperative illustrations from local or community scenes, will introduce an innovative quality to classroom procedures and techniques.

Much can be accomplished by instructors localizing this supplement to provide the climate needed in acquainting students with what cooperatives operating in the business community are or are not, and the opportunities afforded for a satisfying and mentally rewarding place to make a career.

Objectives are stated at the outset of each unit. Likewise, at the end of each unit there are suggested assignments for students as individuals or in group activity.

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UNDERSTANDING YOUR COOPERATIVES

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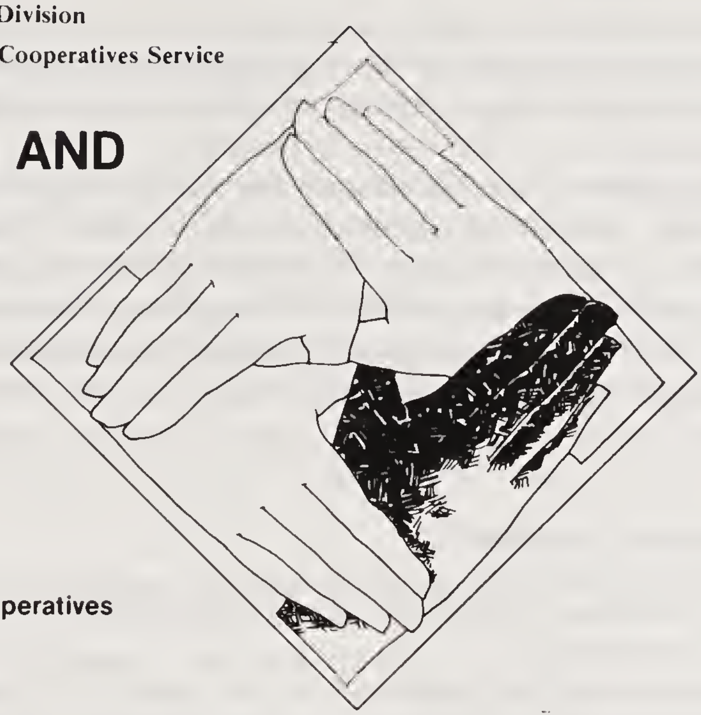
PRINCIPLES AND PRACTICES



LESSON 1

Understanding your cooperatives

Objectives

— Develop an understanding of the cooperative business.
— Identify cooperatives in the community and services they provide.

1-1. What Does Cooperation Mean?

Cooperation means the voluntary act or operation of joining resources—physical, mental, and material (including capital)—to achieve an end. Physical or natural resources above, on, or under the land and sea surface provide the basis for producing the commodities for everyday living. Nothing happens to the physical resources until the human resources of labor and management use material, capital, or an aggregation of other goods to develop them into useful and enjoyable products.

1-2. Why Cooperate?

People cooperate to gain a mutual benefit for themselves and others. People work together to accomplish something that probably could not be done individually. They work together when they see that collective effort will make it easier to solve problems or perform a certain job. They may want to add to their income, reduce expenses, or provide more efficient, economical, and dependable services not readily available in their community.

1-3. What Are Two Basic Types Of Cooperation?

Two basic types of cooperation are informal or unstructured and formally organized. Informal or unstructured cooperation starts with two or more people starting a joint effort to perform a certain job or supply needed goods and services.

Formally organized organizations evolve when people discover that informal or temporary arrangements are unable to perform the job, attain the services, or maximize the benefits or efficiencies desired.

Some formal organizations are established as nonbusiness or nonprofit entities such as churches, schools, recreation facilities, farm organizations, community kindergartens or others. These formal nonbusiness organizations may be chartered under a special State statute for this purpose.

Other formal organizations are established for strictly business purposes, such as banks and credit unions to provide or perform services for pay. When more than a few people (usually 3 to 5) are involved, most States have statutes under which business organizations are chartered. When people formally organize businesses to market their own products, purchase their supplies, or provide themselves services, they charter under a separate statute in most States, provided for cooperative corporations.

1-4. What Is A Cooperative Business?

A cooperative is a business voluntarily owned and controlled by its users and operated for them on a nonprofit basis.

Cooperative understanding and definitions are as varied as the aspects of the cooperatives and the background and viewpoints of people making them. Some are all-inclusive, others emphasize particular aspects such as economics, social, or legal phases. An additional definition will help you understand the nature and objectives of cooperatives. For example: "A cooperative is a voluntary contractual organization of persons having a mutual ownership interest in providing themselves a needed service(s) on a nonprofit basis. It is usually organized as a legal entity to accomplish an economic objective through joint participation of its members. In a cooperative, the investment and operational risks, benefits gained, or losses incurred are shared equitably by its members in proportion to their use of the cooperative's services. A cooperative is democratically controlled by its members on the basis of their status as member-users and not as investors in the capital structure of the cooperative."[1]

1-5. What Does A Cooperative Do?

A cooperative provides its user-owners goods and services at cost of operations.

Cooperative enterprises belong to people who use their services, the control of which rests with all members, and gains of which are distributed to members in proportion to the use they make of services provided. Cooperatives are business organizations usually incorporated, owned, and controlled by members or stockholders as patrons. They operate on a cost basis after allowing for expenses of operation and maintenance and any other authorized deductions for expansion and necessary reserves.

The basic purpose of cooperatives is to give groups of people opportunity to serve their own needs and solve their own problems more effectively than when acting individually.

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[1] USDA's definition of a cooperative in Cooperative Criteria, Farmer Cooperative Serv., Serv. Rpt. 71, Feb. 1965.

1-6(A). Where Does A Cooperative Fit In The American Private Competitive Enterprise System?

As business organizations, cooperatives are a method of doing business under the American private competitive enterprise system. Cooperatives are usually incorporated. Incorporated cooperatives are classified in our American business enterprise system as one form of corporation—a member-user-owned cooperative corporation.

Methods of doing business under the American private competitive enterprise system are conducted by three types of legal business firms: (1) Individual ownership, (2) partnership, and (3) corporate form. The corporate form of business is divided into two kinds—investor-owned corporation and member-user-owned cooperative corporation.

In an investor-oriented corporation people, called investors, invest their money to obtain a profit from service to others called customers. In a cooperative-oriented corporation, people, called members, invest their money to obtain services for themselves. Members are the investors and the customers, called patrons, in a cooperative corporation.

1-6(B). What Are The Features Of The Methods Of Doing Business?

(Optional. Use information on chart for discussion)

1-7. How Is A Cooperative Like Other Businesses?

Cooperative businesses are like other corporate business organizations in physical appearance, functions or services performed, and operations based on sound business practices.

Cooperative corporations physically resemble other corporate forms that perform similar services. They employ personnel with like training to perform similar jobs. They usually charge the same price for items bought and may pay the same market prices for products marketed by members through them. The owners elect a board of directors. The board hires a manager and makes general policies. The manager runs the day to day business and must use sound business practices for the cooperative to survive as a useful organization for members.

1-8. How Is A Cooperative Distinctive?

Agricultural cooperatives have five distinctive features. The first distinctive feature is democratic member-user control.

For a farmer cooperative to come within the protection of the Capper-Volstead Act, it must either limit annual dividends on stock or membership capital, *or* restrict voting rights to one-member, one-vote.

It is fundamental that those who use and benefit from the organization must own and control the business. Otherwise, the benefits members are seeking may not materialize. Member-users of a cooperative corporation in most instances have one vote, no matter how much they have invested in it, or how much they may patronize, that is, use the organization.

This characteristic, however, is not indispensable. In some cooperatives, the basic membership vote is supplemented to permit additional votes based on the previous year's patronage in dollars, or volume such as hundred pounds of milk, or cartons of fruit marketed. In a few cases, a maximum number of votes, such as 5 to 10 is established. This

voting procedure is in contrast to regular corporations that allow voting power in proportion to shares of stock owned, or voting power in proportion to investment.

The democratic principle is steadfastly maintained by relating voting power to use of the cooperative's services. The member as a voluntary participant using the cooperative usually has a greater interest in its progress and success.

Members vote to elect the board of directors at the annual membership meeting. This gives members a voice in controlling the business they own and use, because directors represent members. Directors decide policy and are responsible to the members for efficient operation of their cooperative. The board of directors hires a manager as in all corporate firms.

1-9. How Is A Cooperative Distinctive?

The second distinctive feature is service at cost.

This is also called operation at cost. Any net savings, called profit or net income in investor-owned corporate firms, made after paying expenses belongs to the members patronizing the cooperative. It is divided at yearend among the member-users according to the amount of business each does with the cooperative.

When the net margin is returned to member-users, it is known as a patronage refund. At least 20 percent of patronage refunds by law must be returned to patrons in cash. Remaining portions may be allocated to each patron's account when retained by the cooperative to provide additional capital.

The cooperative organization papers—including bylaws and marketing contracts—usually contain provisions obligating the return of margins in excess of cost to its member-users. This legally binding contract is in effect before any transaction takes place; thus the net margin never becomes corporate income. This net margin belongs to the member-users.

Because cost cannot be estimated accurately in advance, patrons of cooperatives usually pay the "going or competitive price" for goods or services purchased and generally receive an advance for products marketed by their cooperatives less than the actual value of the product. Adjustments are made at the end of the year when costs are known and the amount of any necessary adjustment is then returned to member-patrons. When cooperatives return or allocate all net margins to patrons they are, in effect, adjusting operations to a cost basis. The patronage refund is not taxed as corporate income.

Federal income tax laws of this country set up certain criteria that cooperatives must adhere to so tax obligations are met at either the cooperative or patron level.

Patronage refunds derived from marketing products or obtaining production supplies are, by contract, member income. These patronage refunds are listed on each member's personal income tax form for taxation.

Patronage refunds are a convenient means of helping members finance cooperatives. The portions not distributed in cash are often issued in noncash form as certificates or other forms of evidence of ownership to show members have certain amounts of accumulated capital credited to them. When sufficient capital is built up, these certificates may be redeemed in the order issued.

Some cooperatives do not distribute patronage refunds on the same basis to both members and nonmembers. When business is transacted with nonmembers, these cooperatives may return patronage refunds only to members. Others distribute to nonmembers but at a lower rate.

To the extent that members receive patronage refunds derived from business done with nonmembers, the cooperative has realized a business profit. Under these circum-

stances, patronage refunds to members may include elements of corporate net income, which is taxable. However, many cooperatives strictly adhere to the operation-at-cost principle and distribute refunds to all patrons at the same rate.

1-10. How Is A Cooperative Distinctive?

The third distinctive feature is limited returns on money members invest in their cooperatives.

Capital is as necessary in cooperative businesses as in other firms. However, capital invested in cooperatives is only a means to an end. Members of cooperatives are interested primarily in advantages they derive as patrons of the organization—not as an outlet or place to invest capital at a high rate of return.

Because benefits in cooperatives are distributed to patrons on the basis of their use of services, such benefits do not enhance the value of shares of stock or provide a return on invested capital.

Members of cooperatives must provide most of this capital for operating funds and facilities either by direct subscription or by investment of their patronage allocations. For this reason, the equity capital of cooperatives comes, for the most part, only from member-patrons.

Limitation by cooperatives of returns on capital is recognized in both Federal and State laws. These laws specify the maximum returns that may be paid on invested capital. Cooperatives may choose to pay any amount less than the maximum. In most State statutes, the limit on capital returns is fixed at 8 percent, although in a few States, it is lower or higher. The basic Federal cooperative law—The Capper-Volstead Act—recognized the principle of limited returns on capital by setting a maximum dividend rate of 8 percent per year if members vote on any basis other than one-member, one-vote.

Agricultural cooperatives that qualify under Section 521 of the Internal Revenue Code are required to limit dividends on their capital stock to 8 percent a year or the legal rate of interest in the State of incorporation, whichever is the greater. This legislative recognition of the limitation of returns on capital in a cooperative business enterprise provides legal sanction to a business procedure already recognized as sound among cooperatives.

1-11. How Is A Cooperative Distinctive?

The fourth distinctive feature is that the cooperative is member-owned and financed.

People forming cooperatives are owners. Owners not only invest their money in the business, but they also agree to use the cooperative's services.

People who want to remain independent, to own and operate their own business firms, and to increase their earnings as much as possible are interested in cooperative membership.

In a cooperative, many people with similar problems, interests, and desires can join together to combine their investment and influence in a business or service field. They retain their right of individual ownership and decisionmaking, and at the same time enjoy the advantage of mutual effort on pooling their resources to obtain needed services.

Cooperative owners are called members, member-patrons, or member-owner-users.

There is a tendency to associate farmers with cooperatives. Actually, both farmers and city people use and are benefited by cooperatives.

1-12. How Is A Cooperative Distinctive?

The fifth distinctive feature is that operations are limited.

The Capper-Volstead Act provides farmers "may act together" in collectively marketing their products in their own association and also by joining with other associations of producers to have a common marketing agency. This is generally known as limited antitrust exemption to producers.

The act establishes certain limitations an association of producers must meet to qualify for such exemption. An association must be operated for the mutual benefit of its members insofar as they are producers of agricultural products. Second, an association must not deal in products of nonmembers in an amount greater in value than such products that it handles for its members.

The Capper-Volstead Act also protects the general public by limiting the possibility of undue price enhancement as a result of any monopoly position that a group of producers could legally achieve by getting together.

Adherence to the five distinctive features discussed will not in itself guarantee success to any cooperative organization. There is no business magic in cooperation itself. It merely enables members to legally operate in business in such a way that benefits achieved come to them.

1-13. What Are The Advantages Of A Cooperative Over Other Forms Of Business?

Cooperatives have certain advantages over other forms of business. Some of these have been suggested in the distinctive features. To the extent that cooperatives are able to use these distinctive features for benefit of members, they become business advantages.

Service or operation at cost is a key feature in tying benefits to use of the organization. While other firms seek to make a profit for the benefit of investors, cooperatives seek to provide services that result in increased net income for their member-users. Members using the organization most logically become those who benefit most from using the services.

Democratic member control, or restricting voting rights to one-member, one-vote, as set forth in the Capper-Volstead Act, provides that member control is shared equally. The act of voting on an equal basis with other members helps those persons desiring to retain independance feel greater involvement in the cooperative business.

The distinctive feature of limited returns on investment, also provided in the Capper-Volstead Act, plus voting on a basis other than investment, makes successful cooperatives safe from outside takeover. Profit incentives that cause persons to invest in corporate stocks are not present in cooperative stocks. Strict adherence to this characteristic of limited returns has not always been easy. In some instances, early farmer associations drifted into hands of individuals or groups other than cooperatives because control was based on capital with no limit placed on the amount of returns on that capital.

1-14. What Are The Disadvantages Of A Cooperative?

Cooperatives have certain disadvantages compared with other forms of business.

The distinctive feature of limited returns on investment means sources of cooperative financing usually are limited to direct member subscription and investment of patronage allocations. The cooperative uses member investments as security in borrowing additional capital from banks, including Banks for Cooperatives, and other lending agencies.

A second disadvantage is the need to educate members. Because cooperatives do have distinctive features, member-owners need to understand these features and explain them to others. Members must be provided both good and bad facts by their cooperative—what it is, how it functions, what are its problems, and options or choices they have when voting in meetings. After members get information by newsletter, newspaper or magazine, at meetings, or through personal contact, they must have opportunity to ask questions, and express their desires and opinions to the cooperatives' board and management. Adequate funds to conduct required educational programs must be allocated.

A third disadvantage of agricultural cooperatives is based on another distinctive feature—limited scope of operation. The association must benefit members and is limited in the amount of business it can do with nonmembers. Thus, possibilities of expansion are limited to membership growth and member business.

1-15. How Are Cooperatives Organized?

Cooperative classification is often difficult because cooperatives are involved in most any activity. A logical and practical classification for cooperatives requires various approaches—organization, type, and legal status.

Cooperative organization is based on membership. Those associations serving relatively restricted areas may be centralized local or regional cooperatives.

Centralized local cooperatives have individuals as members. The members usually live within a well-defined area. Membership, for example, may be restricted to an area that grows a particular kind of crop, or consist of employees of a business organization sponsoring a credit union, or live in a housing cooperative, or reside in a geographic trade area comprising one or several counties. Local associations may be completely independent or they may affiliate with one or more other cooperatives.

Centralized regional cooperatives are often expanded local cooperatives with a number of outlets covering a larger area. Individuals are members of centralized cooperatives just as they are in locals. Centralized cooperatives have one central office, one board of directors, and one general manager responsible for the entire operation, although several or many branch offices may be involved. They may serve patrons within the relatively restricted membership area of a single State or several States.

1-16. How Are Cooperatives Organized?

A second member organization approach is the federated regional cooperative.

Federated regional cooperatives are actually cooperatives of cooperatives. Members usually are local cooperatives, operated by local managers appointed by and responsible to local boards of directors. Each local cooperative in a federated cooperative is a separate corporate entity. The local cooperative holds the voting stock rather than individuals.

Federated cooperatives, often called federations, have their own general manager and staff. The board of directors is elected by and represents local affiliated cooperatives.

While local cooperatives are independent in organization and operation, they depend in varying degree on the federated regional for a variety of services. Some federated cooperatives in practice may appear much like centralized cooperatives, depending on added services, activities, or responsibilities they contract with locals. These may include credit or financing arrangements, distributing supplies direct to individual members of locals, management contracts, accounting procedures, and educational programs.

Federated regionals may furnish marketing, processing, arranging and coordinating shipments, and handling of surplus products; maintain product standards; use market contracts; and do product promotion for local cooperatives.

Federated regional purchasing cooperatives may procure supplies in large volumes, engage in manufacturing, conduct research, and provide various related services, such as financing, data processing, and insurance. Federated regionals may provide only services, such as financing, data processing, advertising promotion, employee training, education, legislative affairs and others.

Members owning and controlling local cooperatives are the principal beneficiaries of federated operations.

1-17. How Are Cooperatives Organized?

A third member organization is called a mixed cooperative.

Mixed or hybrid cooperatives frequently develop among federations. Large producers become members along with local cooperatives. In some cases many individuals may be served through branches. Sometimes small federations and locals become members of larger federations. Federated and centralized regionals may also form federations called interregional or national cooperatives.

1-18. What Types Of Cooperatives Are Operating?

Cooperative operations or functions performed are a method of classifying associations. Cooperative operations differ from each other in the way members use them: purchasing production supplies, marketing what they grow or produce, and providing a wide range of services. Many cooperatives perform a combination of either or all of these functions.

1-19. What Does A Purchasing Cooperative Do?

Purchasing cooperatives, often called production supply, farm supply or supply cooperatives, provide farmer-members with the many inputs they need for their farm operations. Major items include feed, fertilizer, and petroleum products, while smaller volume items include seed, pesticides, building material, and others.

Most cooperatives have in some way affiliated with other cooperatives, often through national and international federated cooperatives in efforts to reduce farmer costs. Through federated cooperatives, they may establish plants to manufacture or process paint, batteries, tires, small tools, feed petroleum, pesticides and other products; or they may purchase products in large volume or in the natural state such as phosphate, process them, and manufacture them into fertilizer materials. Distribution to producer members is a major concern at the local level because added services are needed.

1-20. What Does A Marketing Cooperative Do?

Marketing cooperatives, at the first handler level, market about one-third of all products farmers sell. Marketing cooperatives are organized to market any of the many products farmers produce—dairy, fruit, vegetables, grain, livestock, rice, forest products, and many specialty products. Farmers may sell their products through their marketing cooperative as raw products. Other cooperatives construct or purchase facilities to process

the raw products of members. For example, a citrus cooperative may own and operate juicers, evaporators, and freezers to process members' fruit. Some marketing cooperatives, such as dairy, poultry, and livestock, process and retail their members' products.

1-21. What Does A Service Cooperative Do?

Service cooperatives provide services related to the production and marketing of farm commodities, or they may provided general services.

Related service cooperatives perform services that affect location, form, or quality of the farm products or supplies handled for members. Services may be part of the operation or they may be performed by separate cooperatives. Examples of services related to handling farm supplies are trucking; applying fertilizer, lime, or pesticides; harvesting; grinding; and feed mixing; plus many more.

General service cooperatives provide a number of specialized services assisting farmer members in their business. Credit is provided through the Farm Credit System and credit unions for rural residences. Rural electric and telephone cooperatives provide their respective services. A long list of insurance cooperatives, mutual irrigation cooperatives, dairy herd improvement associations, artifical breeding cooperatives, research cooperatives, pest management cooperatives, grove care cooperatives and many more exists.

1-22. What Are Cooperatives' Legal Status?

Legally, cooperatives are classified as unincorporated and incorporated and whether set up on a stock or nonstock plan.

Unincorporated cooperatives have a legal status somewhat similar to a partnership. They are usually small, informally operated, and require few facilities or little capital.

Cooperative business ventures are generally incorporated under special cooperative State statutes. While cooperatives have distinct features, they are as much a corporation as any other business corporation.

In incorporated cooperatives organized on a stock basis, members receive stock certificates as evidence of their ownership interest in the cooperatives. If the organization is organized on a nonstock basis, certificates are issued to show membership and others are issued to evidence capital contributions. The latter are often revolving fund certificates. Many nonstock cooperatives raise original member capital through collecting membership fees. It still takes member capital to operate a cooperative business regardless of legal and financial structure.

1-23. What Are Cooperatives' Legal Foundations?

Cooperatives' legal foundations lie in the Capper-Volstead Act and the State statutes that they use for chartering.

The Capper-Volstead Act, discussed in some detail under the distinctive cooperative features, was enacted in 1922. The act entitled, "An Act to Authorize Association of Agricultural Producers" gave agricultural producers permission to act together to collectively market their products. The act also spelled out in considerable detail the requirements a cooperative must meet to maintain the protection afforded by it. Abrahamsen[1] summarizes the major provisions of the act as follows:

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[1]Martin A. Abrahamsen. Cooperative Business Enterprise. 1976. McGraw-Hill, Inc. pp. 195-196.

"The cooperative must operate for the mutual benefit of members.

"Members can be only farmers, planters, ranchmen, dairymen, nut or fruit growers.

"A cooperative, to obtain the protection of the act, must operate so that nonmember business does not exceed member business, and either (1) no member shall be allowed more than one vote because of amount of stock or membership capital he owns, or (2) dividends on stock and member capital cannot be in excess of 8 percent.

"A cooperative may be incorporated or nonincorporated.

"A cooperative may be organized on a stock or a membership basis.

"A cooperative may have marketing agencies in common.

"The cooperative may engage in processing.

"Only marketing cooperatives are covered by the act.

"Consumers are protected from unreasonable price enhancement by cooperatives under provisions of section 2."

Every State has one or more statutes authorizing formation of cooperative corporations. Some States provide for agricultural cooperatives, nonagricultural cooperatives, and nonprofit organizations. In some cases, it may be more feasible to incorporate under the regular incorporation laws of the State and establish bylaws to operate as a cooperative.

These laws specify the type of information that must be included in the articles of incorporation and designate the official with whom the articles must be filed. Copies of these laws can be obtained from the proper State official, usually the Secretary of State or Corporation Commissioner.

Suggested Assignment

— Make a study and report on the organization, operations, and services of the cooperative that is cooperating in your work experience assignment, or of a cooperative in the community.

Selected References

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Films

"How People Do Business in Our Democracy," 1974, 18 minutes, 16 mm, sound, color, American Institute of Cooperation. Available through regional cooperatives, Farm Credit Banks, or State cooperative councils.

"Cooperatives—The Farmers' Way," 1975, 24 minutes, 16 mm, sound, color, Economics, Statistics, and Cooperatives Service and American Institute of Cooperation. Available through regional cooperatives, Farm Credit Banks, State cooperative councils, or land grant university libraries.

HISTORICAL COOPERATIVE DEVELOPMENTS

LESSON 2

Understanding your cooperatives

Objectives

—Understanding the development of cooperatives and their legislative support in the United States.

—Understanding cooperative development and legislation affecting cooperatives in your State.

—Learning the extent of present farmer cooperative activity in the United States.

2-1. What Were Early Forms Of Cooperation In This Country?

Cooperative history has deep roots in the United States with a rich heritage beginning with early American colonies. Pilgrim and other early colonial history refers to people working together to get things done. Colonial activities included land and road building, house and barn raising, threshing rings, corn husking bees, community protection, and many other forms of group activity.

Settlers worked together. Those moving west cut trees for openings for early roads. Farmers cut trees and rolled the logs to make openings for crops. Stones were carried from fields and the larger ones cracked and placed in the roads for foundations to prevent wagons from miring in mud.

Early settlers cooperated to make their lives more comfortable and safer. Men with strong arms raised logs for log cabins, barns, and stockades. Others with sharp axes notched the logs at the ends to fit in place at the corners.

Farmers formed threshing rings that moved from neighbor to neighbor to thresh the grain. Women worked together preparing big meals for the workers.

Corn husking bees were one of the more enjoyable of these work-sharing events. Youth and adults met at each farm to husk corn. Frequently cider was served and square dancing followed the husking. Young men finding a red ear of corn won the right to kiss a pretty girl.

Sharing labor and resources on farms and providing community protection are as old as American agriculture. These activities were a natural foundation for the development for today's cooperatives.

2-2. How Did Early Cooperative Business Activity Develop?

(A) Earliest purchasing cooperative efforts were informal. Farmers in neighborhoods would get together and pool orders to purchase carloads of supplies—seed, feed, fertilizer, salt, twine, flour, and others. They handled supplies themselves direct from railroad cars to keep costs down.

Farmers looked to cooperatives for markets as they produced more than their families could use. Fruit on the West Coast was an example.

Cooperatives were put on a business basis by farmer participation in buying, marketing and service activities. Formal cooperatives incorporated, elected directors, employed managers, and acquired facilities. Through trial and error, sound business principles and techniques evolved.

(B) Neighbors worked together during time of disaster such as fire or storm. They organized to put out fires by passing buckets of water from person to person. Often the community worked together to repair storm damage or build a new house. Incorporated mutual insurance services developed from these informal efforts.

2-3. What Were Some Of The Earliest Cooperative Businesses?

Benjamin Franklin's efforts to organize mutual insurance companies in the United States date to the mid-18th century. While he worked with Workman's Protective Association of Philadelphia earlier, his efforts in 1752 with the Philadelphia Contributorship for the Insurance of Homes from Loss of Fire and Other Hazards are widely recognized. These early mutual insurance companies were local in nature and emphasized low-cost insurance protection.

2-4. Early Cooperative Of Special Note

The 28 poor weavers living in a factory town are acclaimed widely for establishing the first permanent cooperative in England in 1844. Desperate over poor pay and high living costs, they opened a cooperative grocery store on Toad Lane in Rochdale. This store thrived and grew, inspiring other similar activities in all parts of the world.

They drew on the experience of other pioneer cooperatives in developing their ideas and operating practices. From their practical operating experience they developed the Rochdale principles accepted today by many people as the distinguishing trademarks of cooperative business.

2-5. Early Cooperatives

California citrus growers made their earliest attempt to unite to market fruit by organizing the Orange Growers Protective Union of Southern California in 1885. The Union sent salaried employees to eastern markets to oversee distribution of members' fruit. It did not require holders to use its buying, selling, and shipping services, so the Union lacked organization and coordination. After a few years, it ceased operating; it was revived again briefly in 1890, only to disband in 1893.

Three other organizations attempting to harmonize grower and packer interest were formed about the same time as was the Union. These attempts to deal with divergent interests of growers and packers within a single organization soon failed.

Continued cooperative organization attempts were made to overcome marketing problems. They faced antagonism of fruit brokers and commission men, friction between officials attempting to work together, large crops, low returns, and violations of the principle of local democratic control.

Basic cooperative principles adopted with formal incorporation of California Fruit Growers Exchange in 1905 are in effect today. The corporate name was changed to Sunkist Growers, Inc., in 1952 to more definitely associate the Sunkist trademark with the organization.[1]

2-6. Early Cooperatives

Other producers tackled their own problems by forming organizations that were cooperative in purpose and character, if not entirely so in structure. Many efforts were pursued, not as reform measures, but rather as steps to open commercial channels not yet developed.

In Ohio, for example, Miami Exporting Company was organized in 1803 as the first formal farmer cooperative to find markets for the farm products of the State. This cooperative, aimed chiefly at giving assistance to farmers, was composed of both farmer and merchant members.

The first known local cooperative handling farm supplies started at Riverhead, Long Island, in 1863 to buy fertilizer wholesale for members near New York City. This association operated on a cash basis, requiring gold to order and purchase fertilizer materials.

2-7. Early Cooperatives

(A) Little is known about earliest cooperative dairy marketing efforts, but a cooperative creamery formed about 1810 at Goshen, Conn., made history as the pioneering attempt. About the same time, a cheese plant was begun at South Trenton, N.Y.

Probably the outstanding example of an early cheese factory was one established in 1851 in Oneida County, N.Y. This successful effort was followed by the first cooperative butter manufacturing factory in 1856 at Campbell Hall, N.Y.

Cheese, butter plants, and creameries proved popular and successful. Dairymen set examples in early cooperative activity and had established more than 400 cooperative dairy processing plants by 1867.

A group of Welsh farmers organized the Licking Exporting Company near Granville, Ohio, in 1820. This first cooperative hog marketing venture collected the live animals and drove them to Sandusky for slaughter and packing. An agent of the cooperative accompanied the pork product by boat to Montreal to handle sales. These efforts proved unprofitable.

However, 17 farmers in Bureau County, Ill., had more success. During 1 week of operation in 1860, their fourth year of cooperation, farmers brought 504 dressed hogs for sale on the Chicago market.

Other livestock shipping associations developed rapidly. They enabled producers with less than a carload to sell on terminal markets by making up a carload with neighbors, thus contributing to success.

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[1]The Sunkist Adventure. C. H. Kirkman, Jr. FCS Information 94. 1975. pp. 9-12.

(B) The first known grain elevator was started in 1857 at Madison, Wis. Fruit Growers Union and Cooperative Society was the first association for cooperative fruit marketing. Formed at Hammonton, N.J., in 1867, it expanded to include cooperative purchasing in 1884. It continued operation with the same name until 1897.

In 1874, the Illinois State Grange made the earliest recorded effort to establish a cooperative to market poultry and other farm products. This venture was short-lived and nearly 20 years lapsed before poultry producers made another effort at cooperative marketing.

Many early cooperative business ventures blazed new trails and then disappeared after they had filled the need justifying their organization.

2-8. Where Did Early Leadership Develop?

A group of frugal Scotch farmers in North Carolina is reported to have inspired the formation of the Grange. Through their association they endeavored to purchase wholesale for a small membership.

Their meager efforts inspired Oliver Hudson Kelley, then a Government clerk checking war-ravaged southern farms. Kelley envisioned a fraternal organization as a means of improving social and economic conditions of farmers. With six fellow Government clerks, he founded the National Grange of Patrons and Husbandry.

While the National Grange used political influence, local-level cooperative selling and buying became a primary activity and grew rapidly. Orders for supplies were combined and volume transactions were made with jobbers and manufacturers at savings. Pooling of farm products for shipment to large markets occurred, bypassing tolls of commission men and dealers.

This success led to establishment of cooperative stores at State and national level agencies. Minnesota established the first State agency, 2 years before Grange founders approved the first agent appointment in 1869. Five years later, 1874, 26 States had functioning business agencies. These agencies varied widely in operation.

Iowa was among the most successful, affording large savings on purchases and increased monetary returns on direct grain and livestock shipments to Chicago. However, an ill-fated venture in manufacturing bankrupted this State agency. Similar situations occurred in other States, including Nebraska. In a serious effort to establish sound business practices, the 1875 National Grange annual meeting adopted "Rules for Patrons' Cooperative Associations of the Order of Patrons of Husbandry and Directions for Organizing Such Associations." These "Rules" of Cooperation gave new hope for cooperative effort that probably should be credited with helping save Grange cooperatives' endeavors.

These rules incorporated principles from the Rochdale Plan of Cooperation—limited the number of shares available to patrons, limited the rate of interest per share, limited the vote of each shareholder to one, emphasized the need for cash sales at prevailing prices, and required distribution of savings in proportion to patronage.

One of the largest independent cooperatives developing from Grange efforts was GLF (Grange League Federation Cooperative Exchange) Ithaca, N.Y., serving members in New York, New Jersey, and Pennsylvania. GLF is now Agway.

Grange Life and Auto Insurance, still in existence, was a success from the outset.[2]

The American Society of Equity credited J. A. Everitt, an Indiana farm paper editor, with being the chief organizer of its formation in 1902. Everitt enthusiastically promoted his thesis that organized farmers could garner justified economic benefits and equal the role of either of the other two powers—business and labor.

Equity organized many cooperative enterprises in the North Central States in spring wheat, livestock, potatoes, and general farm produce.

An early test of Equity theories came with an invitation to organize Kentucky burley tobacco growers. Favorable prices of 17 to 20 cents per pound were obtained in 1908 through reducing production to 10 percent of normal. This favorable price was a temporary economic victory because violence and intimidation aroused indignation of law-abiding citizens.

Equity grain elevators were promoted in Montana, Minnesota, and North Dakota, but expected support did not materialize. Equity influence became centered in Wisconsin where a number of livestock and farm supply cooperatives continue to carry the word "Equity" in their names.[3]

2-9. Early Leadership

A local newspaper publisher and editor, Isaac Newton Gresham, founded the Farmers Union in Raines County, Tex., in 1902. By 1905, it was functioning as a national organization and placed major emphasis on cooperative business enterprises.

Charles S. Barrett became president in 1906 and early recognized difficulties in union-operated cotton warehouses. The business-agent system for purchasing farm supplies for members of locals was hampered by lack of cash. To develop a stronger national base, efforts moved to the Midwest with emphasis on cooperative creameries, grain elevators, and livestock shipping associations.

Earliest Midwest success occurred in Kansas, Missouri, and Nebraska. By 1920, activities spread to South Dakota and included flour mills and cooperative telephone companies. About this same time, the Union made cooperative headway in Iowa. The Farmers Union State Exchange, headquartered in Omaha, flourished.

Important grain-marketing achievements were accomplished by the cooperatives now known as the Farmers Union Grain Terminal Association, Minneapolis, and Union Equity Cooperative Exchange, Enid, Okla.

CENEX, St. Paul, Minn., was formed as Farmers Union Exchange to handle farm supplies for affiliates of the terminal association. As business grew, the holding company relationship was dissolved and the name changed to Farmers Union Central Exchange before becoming CENEX.

Farmers Union entered the insurance business in Colorado, soon followed by Nebraska. It continues life, automobile, casualty, and fire insurance sales with a history of low premium rates.[4]

American Farm Bureau Federation, founded in 1919, stepped into a void, except for Farmers Union efforts in the Northwest. It soon became spokesman for organized agriculture and champion of interest in farmer cooperatives. Many Farm Bureau leaders supported and adopted the idea of large national organizations supported by Aaron Sapiro.

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[2]Martin Abrahamsen and Claud Scroggs. Agricultural Cooperation. University of Minnesota. 1957. pp. 10-5

[3]Agricultural Cooperation. pp. 22-25.

[4]Agricultural Cooperation. pp. 25-30.

Special commodity committees were appointed to prepare plans and make recommendations for cooperative marketing agencies to handle grain, livestock, fruits and vegetables, wool, and eggs. Grain, livestock, and fruits and vegetables established national associations. They decided existing dairy efforts were effective. In cotton marketing, the Farm Bureau supported the American Cotton Growers Exchange operating in Arizona, Texas, and Oklahoma.

In April 1923, Farm Bureau hired Aaron Sapiro as legal adviser for cooperative marketing. He was already legal counsel for many of the new commodity cooperatives and a speaker of remarkable persuasive talent. A difference in ideas and strategy developed among Farm Bureau leaders. It became so intense that Indiana State Farm Bureau withdrew membership for a period.

Upon review of Farm Bureau policy with 9 of 12 members new on the executive committee, Farm Bureau ended its action programs in cooperative marketing. Edward A. O'Neal, a retained member of the executive committee, and later president, insisted Farm Bureau return to fundamentals—field service, legislation, research, and transportation.

The national headquarters became the adviser to affiliated State and local cooperative associations that continued to make outstanding achievements in marketing and purchasing farm supplies in many States. Farm Bureau companies offering various types of insurance have shown remarkable growth. Probably the greatest Farm Bureau insurance success story is Nationwide Insurance Companies started in 1926 by Ohio State Farm Bureau with Murray D. Lincoln as founder and first president.[5]

Examples of Farm Bureau sponsored cooperatives include Landmark, Columbus, Ohio; Indiana Farm Bureau Cooperative Association, Indianapolis, Ind.; and Illinois Agricultural Association, Bloomington, Ill. County cooperatives are members of these regional cooperatives. The regionals have then established the interregional cooperatives for obtaining supplies or providing farmers markets for their products.

2-10. What Differing Schools Of Thought Developed?

Aaron Sapiro became a national cooperative figure during the twenties in promoting the Sapiro plan. He specialized in organizational structures and marketing contracts. The slogan of the day became orderly commodity marketing and was referred to as "The Legal Monopoly."

His plan dispensed with local associations. Farmers became direct members of a centralized association through purchase of membership certificates or shares of stock and through signing ironclad long-term marketing contracts. Control and authority were vested in the headquarters organization. The plan was aimed at controlling large segments of the market supply, so cooperatives would have monopolistic power.

His hypnotic speech at Montgomery, Ala., in April 1920 inspired efforts to apply the Sapiro method to State and regional single-commodity cooperatives for marketing cotton, tobacco, wheat, peanuts, white potatoes, sweet potatoes, rice, olives, milk, melons, alfalfa, and poultry. In speaking to farmers, he reduced his economic philosophy to simple terms—a monopolistic concept or enough control of the supply so as to fix or influence price. His concept proved difficult to apply in practice because he overlooked membership and overemphasized the legal aspects.

Irrespective of difficulties, his plan is reflected in many centralized cooperatives today.

[5]Agricultural Cooperation. pp. 30-39.

2-11. Schools Of Thought

Edwin G. Nourse, one of the founders of American Institute of Cooperation, believed the Rochdale principles ought to be reexamined in light of changing agricultural conditions. He emphasized the role of marketing cooperatives with the central ideas of democratic control, limited returns on equity capital, and distribution of savings to members on the basis of their patronage.

His greatest contributions to cooperative thinking were his emphases on business efficiency, equitable distribution of control and benefits, and the relation of law to cooperative structure and operations. Nourse believed that efficient cooperative performance depends on avoiding unnecessary duplication of effort, identifying member needs with association performance, achieving sufficient size to bargain effectively, and adjusting production to market requirements. Nourse also stressed that cooperatives should be an effective tool for equitable distribution of wealth. His emphases on limited capital holdings, restricted voting privileges, and democratic control brought into focus the importance he attached to the individual member.

To round out his philosophy regarding cooperatives, Nourse feared political expediency in Government. He believed that the inherent conflict of self-help versus Government assistance was unresolved. Nourse was a staunch foe of monopolies, and looked on cooperatives as a counterbalancing force that could help farmers to achieve equality in the marketplace.[6]

2-12. What Has Been The Role Of State Government In Farmer Cooperative Development?

Cooperatives' legislative support, development, organization, and operation involved many years of struggle, experimenting and interest. Farmers had active encouragement and assistance from farm organizations, land-grant universities, and others. The farm organizations worked with cooperatives to enact Federal and State legislation.

Michigan passed what is believed the first law recognizing the cooperative method for buying and selling in 1865. However, the New York legislature had legalized cooperative mutual town fire insurance companies earlier in 1857.

State enactment of special cooperative statutes until 1920 moved slowly. However, between 1920 and 1930, numerous laws were passed and several passed in earlier years were amended and revised. All States now have cooperative statutes with a high degree of uniformity although varying in particulars. Statutes of Wisconsin, Nebraska, and Kentucky were used as patterns.

2-13. Government Role

Not all Federal laws that affect cooperatives grant a privilege or exemption. Some laws are general in nature yet have had a profound influence on cooperatives.

The Smith-Lever Act passed in 1914 created the Extension Service, now the Science and Education Administration, in the U.S. Department of Agriculture. Financed cooperatively by Federal, State, and county funds, the Extension Service placed personnel at State and local levels where farmers needed marketing and supply services. Extension personnel worked closely with farmers and farm organizations in educational organizations and operations for cooperatives.

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[6]Martin A. Abrahamsen. Cooperative Business Enterprise. McGraw-Hill Book Co. 1976. pp. 79.

2-14. Government Role

The Capper-Volstead Act of 1922 was discussed at length in lesson one as distinctive cooperative features were enumerated. The Capper-Volstead Act is a limited exemption from the antitrust laws granted to farmers in their marketing activities. It permits farmers to associate together in the marketing process where such cooperation might otherwise be an antitrust law violation, but it does not give unlimited exemption to the association once it is formed. It is the foundation for cooperatives marketing agricultural products to act as the farmers' agent.

2-15. Government Role

Cooperative research and education work begun by the U.S. Department of Agriculture in 1913 was strengthened and formalized in 1926 by the Cooperative Marketing Act. This act authorized research, technical assistance, and educational work be conducted with farmers and cooperatives in a division of cooperative marketing in the U.S. Department of Agriculture. Starting in 1933, this program was carried on by the Cooperative Research and Service Division of Farm Credit Administration. This division became Farmer Cooperative Service (FCS) in 1953 to more directly identify the work of the U.S. Department of Agriculture with cooperatives. Reorganization in the Department in December 1977 combined FCS with three other groups into a larger agency called Economics, Statistics, and Cooperatives Service. Three divisions—Cooperative Marketing and Purchasing, Cooperative Management, and Cooperative Development—conduct the cooperatives program in the larger agency.

The Cooperative Marketing Act permits exchange of various types of information among agricultural producers and their marketing associations. The full effect of this provision is not clear but it does appear to permit exchange of information among cooperatives that would otherwise be an antitrust law violation.

2-16. Government Role

The Farm Credit Act of 1933 recognized the credit needs of farmers' marketing, supply, and business service cooperatives. It provided for the establishment and initial capitalization of the 13 Banks for Cooperatives.

The Banks for Cooperatives provide dependable and economical lending services for cooperative facilities, operations, and commodity loans. This enables cooperatives to establish a sounder financial basis through advice on business and financial practices.

Congress had earlier passed the Federal Farm Loan Act of 1916, establishing Federal Land Banks and Federal Land Bank Associations (then called National Farm Loan Associations) for long-term loans to farmers. Congress also passed the Agricultural Credit Act of 1923, providing establishment and capitalization of 12 Federal Intermediate Credit Banks to discount agricultural producers' notes given to other financing institutions.

The Farm Credit Act of 1933 also authorized establishment of local Production Credit Associations that could discount short-term farmers' notes with the Federal Intermediate Credit Banks.

The three banks—Federal Land Bank, Federal Intermediate Credit Bank, and Bank for Cooperatives—comprise the Farm Credit System. The Farm Credit Administration was established as an agency of Government by Executive Order of the President in 1933 to supervise the Farm Credit System. Later legislation, including the Farm Credit Act of 1971, has passed Congress, but the basic organization exists as we know it today.

2-17. Government Role

Passage of the Rural Electrification Act of 1936 is further evidence of Government support of cooperative endeavor.

Rural Electrification Administration (REA) was created by Executive Order of the President in May 1935 after a study and farm organization interest to "initiate, formulate, administer, and supervise a program of approved projects with respect to the generation, transmission, and distribution of electric energy in rural areas." In August 1935, the President issued the regulation establishing REA as a lending agency. Although the first year was a disappointment, Congress passed the Rural Electrification Act of 1936 reestablishing REA as a lending agency for 10 years.

Action came quickly as the agency encouraged and financially helped rural electric cooperatives provide electric service. In the face of opposition, electric lights began coming on all over America at reasonable costs.

The Rural Electrification Act was amended in 1949 to make the telephone loan program a responsibility of REA.

Helping improve the living conditions and business climate of rural areas through its rural electric and telephone program continues as a major component of REA's efforts.

2-18. What National Organizations Serve Farmers Cooperatives?

Cooperatives formed trade associations to create public understanding, promote their interest, and represent them in public and governmental affairs.

American Institute of Cooperation (AIC) was incorporated in 1925 as a National educational organization, a university without a campus. From the first AIC session in Philadelphia in 1925, AIC has brought together outstanding educators and agricultural leaders as instructors in an unequaled cooperative educational venture. As its founders envisioned, AIC makes special efforts to stimulate sound and constructive thought and educational activity on cooperative principles, practices, and operations as they relate to economic and public interest aspects of cooperatives.

AIC serves as a coordinator, a catalyst, and central focal point for education and information on cooperative educational programs, materials, ideas, and concepts available through cooperatives and educational institutions. It provides service to members through the National Institute on Cooperative Education and other conferences relating to cooperative personnel endeavors.

Members are primarily marketing, supply, farm credit, and rural electric cooperatives.

Cooperative League of the USA (CLUSA), established in 1916, is the oldest of national cooperative organizations.

Included in its diverse membership are national, regional, State, and local cooperative organizations, serving members in housing, health, credit, consumer goods, farm marketing and supply, mutual insurance, education, rural electrification, and travel.

In behalf of these members, the League has six major functions: (1) to advance public knowledge of cooperatives, (2) to improve the skills of cooperative directors and employees, (3) to encourage wise cooperative financing and operative policies, (4) to help cooperatives strengthen their member relations, (5) to seek Federal laws and adminis-

trative decisions consistent with cooperative aims and purposes, and (6) to promote development in the world's less-developed areas, both at home and abroad, through cooperatives.

The Cooperative League persists in efforts to encourage sound cooperative development in this country and overseas.

The League also produces and makes available a wide variety of cooperative educational and training materials, including basic how-to manuals.

National Council of Farmer Cooperatives (NCFC), organized in 1929, promotes growth and effectiveness of cooperatives, primarily through national legislative and regulatory assistance.

Members of the National Council include 108 operating cooperatives and 32 State councils of cooperatives.

These members range from small cooperatives marketing several million dollars worth of agricultural commodities annually to large cooperatives supplying more than $1 billion worth of farm inputs annually.

The National Federation of Grain Cooperatives merged with NCFC and now serves as the Grain Federation Division. This division promotes common business interest of regional grain cooperatives and their members through legislation, information on government regulations, and help in dealing with State and Federal agencies.

Total memberships increased from slightly more than 7 million in 1950-51, to a high 7.7 million in 1955-56, followed by a quite consistent decline to 5.9 million in 1976. This trend reflects the decline in the number of farms, although the drop in number of cooperatives has been less pronounced.

During this same period, marketing, farm supply, and related services cooperatives peaked in November at about 10,200 in 1951-52 and then declined to the present number of 7,535. Of this number 4,658 cooperatives primarily marketed farm products, 2,731 handled farm production supplies, and 146 conducted related services. Related services include trucking, storage, grinding, drying, and other similar services affecting the form, quality, or location of farm products and supplies handled for cooperatives.

The National Council and its Grain Federation Division represent more than 75 percent of the total business volume of agricultural cooperatives, and include a combined farmer membership of about 1.5 million.

The National Council has sought to create and maintain a favorable political and economic climate in which farmers and their cooperatives can do business.

The National Council's philosophy is keyed to the premise that agriculture, an essential industry, must remain healthy if the U.S. economy is to prosper and grow.

2-19. National Organizations

National Milk Producers Federation (NMPF) provides dairy farmers and their dairy marketing cooperatives with an effective voice in all branches of the Federal Government.

The Federation provides the organizational basis for the development of current policies and long-range objectives sought by dairy farmers and dairy farmer cooperatives. NMPF provides the mechanism to further these policies and objectives legislatively and administratively in the Federal Government.

Representing nearly all dairy marketing cooperatives in the Nation, the Federation serves as an effective voice in carrying information between member associations, Congress, and various Government agencies affecting the industry.

National Rural Electric Cooperative Association (NRECA) provides special services and a representative voice for legislative interests of member-owned electric systems. It is now the service organization for nearly 1,000 rural electric cooperatives and their statewide associations.

In addition to lobbying for legislation of interest to member systems as determined by resolutions adopted at the annual meetings, NRECA provides an insurance program, management and leadership training, counseling service, and research and information services. By formation of the Energy and Environmental Policy Division in the Department of Legislation and Communications in 1973, the association gave additional specialized support to member concerns. This division is responsible for all Government liaison and other association activities related to energy, environmental protection, bulk power supply, and related research.

Credit Union National Association, Inc., (CUNA) is a national nonprofit organization serving credit unions in the United States. CUNA is supported by dues paid by these credit unions.

Programs and services of CUNA are carried on and supported by State units or leagues offering direct assistance to more than 23,000 U.S. credit unions. Through the leagues, CUNA provides programs in financial and economic research, education and development, communications, finance and accounting support, public relations and advertising services, and governmental affairs.

Agricultural Cooperative Development International (ACDI) is chartered as a private nonprofit corporation. The board of directors is composed of experienced cooperative and farm leaders. In addition to establishing policy, it serves as liaison with all U.S. agricultural cooperatives and assists in recruiting capable cooperative technicians to staff long-term and short-term projects in client countries.

Member cooperatives contribute services and funds in support of the overseas cooperative development work of ACDI and other related programs. These include such sponsored efforts as Cooperative Fertilizers International (India Project), and the Volunteer Development Corps which furnishes short-term technicians on a volunteer basis for specialized services as requested by cooperatives in receiving countries. A major part of its activity is conducted under funded contracts with the U.S. Agency for International Development (AID).

2-20. State Cooperative Organizations

State cooperative organizations are trade associations of cooperatives with programs divided into three major areas—legislative, membership and education, and public relations. Organized in about 40 States, they are uniquely useful to cooperatives in providing communication, educational programs, and services individual cooperatives could not afford. Their programs range from simple to ambitious depending on available resources. In some States, council activities consist of a few educational efforts carried on by a part-time executive secretary who may be a State university staff member. In other States, councils have full-time staff members carrying all phases of programs.

The touch of education enclosed in the diamond is the logo of the Iowa Institute of Cooperation.

2-21. What Is The Extent Of Present Farmer Cooperative Activity In the United States?

The number of cooperative members and the number of their memberships in such organizations is often a confusing item in statistical presentations. It is estimated that at least five farmers out of six are members of one or more cooperatives. Also, a limited number of rural nonfarm people join farm supply cooperatives to obtain fuel oil, fertilizer, seed, and appliances. Indications are that, on the average, a cooperative member belongs to between two and three associations. Therefore, the combined number of memberships far exceeds the number of members.

2-22. What Is The Extent Of Present Farmer Cooperative Activity In The United States?

Combined annual net volume of all farmer cooperatives exceeded $40 billion in 1976. Grain, soybeans, soybean meal and oil; dairy products; fruits and vegetables; and livestock accounted for about 80 percent of the $30 billion of farm products marketed. In the farm supply group, three items—feed, petroleum products, and fertilizer accounted for about 70 percent of $9.4 billion of production supply business in 1976. The $0.9 billion farm services refers services related to the marketing of farm products and handling farm supplies.

2-23. What Is The Extent Of Present Farmer Cooperative Activity In The United States?

Farmers' use of cooperatives during the past quarter-century has increased steadily. From the farm, about 29 percent of farmers' products move to the next marketing level through cooperatives. This amount compares with 20 percent in 1950. Dairy products, grain and soybeans, fruits and vegetables, and livestock and livestock products account for more than 83 percent of all products marketed.

The net marketing business of $25.8 billion accounts for sales at the local or farm level. An additional $4 billion volume in marketing and processing increases net sales to $29.8 billion.

2-24. What Is The Extent Of Present Farmer Cooperative Activity In The United States?

Proportions of farm production supplies purchased through cooperatives has increased also—from 12 percent in 1950 to about 18 percent. The increase has come primarily from significantly larger volumes of fertilizer, pesticides, and petroleum products moving through cooperatives.

Cooperative sales for farm production use in 1976 amounted to more than $8 billion. An additional $1.4 billion sales went for nonfarm use for a total of $9.4 billion. Feed, fertilizer and lime, and petroleum products accounted for 73 percent of farm supply expenditures.

Suggested Assignments

—Make a study and report on cooperative development and legislation in your State.

—Make a study and report on the historical development, including changes in services, of the cooperative that is cooperating in your work experience assignment, or of a cooperative in the community and the State legislation affecting its development.

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ECONOMIC DEMOCRACY IN ACTION

Objective

— Determine the responsibility and relationship of key people in a cooperative.

3-1. How Do You Organize A Cooperative?

A few leaders with a common economic problem or need sooner or later begin to share ideas about possible solutions. They may need a market for their products, a satisfactory source of supplies, or some special service. They may decide a cooperative could solve it.

Usually, their next step is to approach a professional worker familiar with the cooperative organization and financing processes. With the assistance of this professional counsel, they assess the need for the cooperative and potential membership and volume. These facts and figures are presented to community leaders and potential members.

Assuming these preliminary figures look promising and people want the cooperative, an organizing committee needs to conduct an economic feasibility study that goes to greater depths in determining the likelihood of the proposed cooperative being successful and beneficial to members. This study may require expert help in economics, finance, credit, law, accounting, engineering, business operations, or other fields of endeavor. This feasibility report includes findings and recommendations on volume of business, operating costs, capital required, sources of supply or outlets, marketing methods, organization, financing, and many more concerns.

Assuming the feasibility report is favorable, the committee has several jobs to do, such as signing up the required number of members with adequate volume potential; obtaining member capital and arranging for capital loans; drafting the legal organization papers, including articles of incorporation, bylaws, and marketing agreements if a marketing cooperative; filing the articles of incorporation; and arranging for and conducting the organization meeting. When organized, all members, including new members, should understand the articles of incorporation, bylaws, marketing agreements, and other legal papers.

3-2. Who Are The Key People In A Cooperative?

Four groups of people are involved in operations of cooperatives. These groups have to make decisions at their respective levels to enable the cooperative to serve. These groups are:

—Members, as the owner-users;
—Directors, as the policymaking body;
—Manager and other key employees, as the operators; and
—Clerical and operating employees, as the workforce.

3-3. What Are The Responsibilities Of Members?

A cooperative has many owners called members. Members, sometimes called stockholders or shareholders, are the foundation on which the cooperative is built. Their similar needs are reasons the cooperative is organized and for its continued existence. Their increasing needs constantly shape the cooperative's future. Their support, through patronage and capital investment, keeps the cooperative financially healthy.

Investing initial capital is members' basic responsibility. Their share should be large enough to make them realize they have a financial stake in the business to want to protect this investment. It should also be a large enough share of capital needs to use as a credit base for borrowed capital.

As a general rule, members' invested capital is in proportion to members' anticipated use of the cooperative. Initial capital investment usually is in cash for which they are issued stock or membership certificates. As the cooperative serves members, proportionate capital investment may be based on volume or value of product, or capital retained from patronage refunds.

3-4. Member Responsibility

Members of a cooperative have a role in management that differs from that in ordinary business corporations. As owners they control the cooperative's primary function of performing needed services for their production operation.

Members, therefore, should be intimately and personally interested in affairs of the cooperative and should have a positive role in its management. They are responsible for the character of the cooperative's management. As members they stand to benefit directly from good management, and results of poor management fall directly on them. As owner-users-members, they have an interest and responsibility with their vote and financial support, to provide for overall management selection, training, and direction.

3-5. Member Responsibility

Experience has shown members do not always assume their responsibilities. Boards of directors and the manager and staff must provide the means and furnish opportunities for members to get the facts they need about their cooperative to carry out their responsibilities. Needed information may be presented through publications, letters, direct contacts or meetings.

The democratic nature of a cooperative entitles every member a vote. While voting is a right, it imposes a responsibility on the member to be informed and to vote intelligently. Thus members must be well informed and attend meetings to ask questions, discuss issues, express opinions, present ideas about ways to make the cooperative perform better, and vote.

Variation exists among cooperatives concerning the detail of proposed policy taken to members for their vote. Basic policy affecting members usually is determined by them. Examples include new marketing contracts, a new or different service offered, major changes in facilities, and capital structure change. Not to be overlooked is that members voted to start the cooperative and most States require a vote to disband it.

3-6. Member Responsibility

Members are responsible for promoting their cooperative association and its objectives. This means members should look on their association as their personal business. This requires that each member provide loyal support. The most important support a member can give is maximum or total patronage support.

For a cooperative to function successfully, it must have a substantial volume of business to obtain operating efficiencies and to generate sufficient cash flow. Members' capital can be further extended in a production or service cooperative by doing as much business for cash as possible and paying bills promptly when credit is extended. Members are responsible also for getting others to join and patronize their cooperative.

3-7. Member Responsibility

Business and community citizenship responsibility is not new for cooperative members. Cooperative members are customers of other community businesses. They fill various positions of community leadership. Participation of the cooperative and its leaders in business, community, and civic programs reflects the total cooperative image.

Being good business neighbors and assuming a real responsibility in building a better community can be most rewarding. What these business neighbors and the community think and say has an important effect on all cooperative members and employees in their respect and allegiance to the cooperative.

Establishing community involvement or relations solely for selfish purposes may backfire, but where member community interest is as great as self interest, both community and cooperative members may profit.

3-8. What Are Responsibilities Of Directors?

A cooperative is a democratically controlled form of business. But members cannot make directly all cooperative decisions. Democratic control is preserved by members electing directors to represent them in many affairs of management.

After a new cooperative is organized, members elect a board of directors from the membership. From then on, members elect a few (usually 7 to 9) of the leading members at the annual meeting to guide the cooperative.

The board of directors occupies a key position between members and paid management. It represents the members as users of cooperative's services, not as capital investors.

Cooperative directors must keep informed of services members need and endeavor to provide them efficiently. In contrast to stress on returns from capital investment, directors need to emphasize cooperative activities most beneficial to members' business, i.e. production supplies, marketing, and services for farmers or ranchers.

3-9. Director Responsibility

Directors discharge their duties as a board. They must deliberate, make decisions, and give instructions as a board, not as individuals.

The board must determine the rules, long range objectives, and plans governing the cooperative to ensure the association will succeed. As the members' representative, they must explore the economic feasibility of supplying anticipated future member needs through the cooperative. Long range plans are of major concern if the cooperative is to serve the real needs of producers as agricultural conditions change. While they may employ counsel, they cannot shift the responsibility to others.

When sufficient information is gathered and a determination is made, the board establishes the general policy to guide the cooperative operation.

3-10. Director Responsibility

While the board has responsibility to establish policy, many aspects of carrying it out can be delegated to the hired management. So a second way the board can meet its responsibility in directing business activities is to hire management. The term hired management is used to include the manager and other key personnel who are delegated management functions.

Employing a competent manager is one of the important responsibilities of the board. Success or failure of the cooperative may depend on how well the board handles this function. While hiring and delegating duties to the manager, the board must set ample clear-cut policies and delegate sufficient authority for the manager to perform these duties successfully.

3-11. Director Responsibility

Although the cooperative board of directors hires the manager and delegates details of operation, it is the board's responsibility to evaluate the organization's performance. It must insist on an adequate bookkeeping system to provide a basis to evaluate cooperative performance.

A complete and accurate bookkeeping system is absolutely essential for management to function properly. A balance sheet and operating statement should be prepared monthly to draw attention to assets and debits subject to rapid change and provide a month-to-month comparison of key items for directors to see what is happening in operations. Operating statements related to operating budget greatly increase the value of each.

Farmer cooperatives need two kinds of special records to perform unique cooperative functions—those to achieve service at cost for members and those associated with member patron financing.

The board must insist on regular external audits of these accounts to varify business records. This independent auditor, employed by the board, presents the report directly to the board to provide it a first hand independent evaluation. Careful study of an audit report reveals the extent the manager has followed board financial policies and

approved budget. It also can indicate whether the cooperative is meeting its basic objectives in service to members at reasonable cost.

3-12. Director Responsibility

Members delegate to their directors authority for checking on the cooperative performance. Directors thus have a responsibility to take active and energetic steps to keep the membership fully informed on association activities and problems.

For directors to report to members, they must understand the key elements of cooperative success and be closely acquainted with the current and forecast progress of the business concerning its various operations. Knowledge of the cooperative's purpose, history, and place in the market are helpful in assessing and reporting to members. The annual audit report showing sales volume of product or services, current value of assets, and the liabilities are helpful in making the report. Directors should be aware of obsolescence of physical plants and keep members aware of their replacement needs. Members are always interested in net margins, patronage refunds, and the ability of employees to provide the products, service, or marketing they desire. Future plans for expanded or new services must be reported to members. While often overlooked, it is important that negative, as well as positive, aspects of cooperative operations be reported to members, so they have an accurate perspective in exercising their ownership responsibilities.

3-13. Director Responsibility

Directors are vested by law with the duties and responsibilities of conducting the affairs of the corporation.

State and Federal statutes governing cooperatives dictate explicit managerial responsibilities for directors. Directors are charged with all corporate powers of an association other than those specified for members.

Although the board of directors must function as a group, each director must assume responsibility and liability for the cooperative's operations and actions—bonds, agreements, customer services, and many more. Each is accountable for board decisions irrespective of presence or absence at a board meeting when the decision is made.

3-14. What Are The Manager's Responsibilities?

The manager supervises and coordinates the cooperative business activities by managing people, the human resources, and managing the physical resources.

In a developing or small cooperative, the manager, employed by the board of directors, may attempt to do everything. In larger cooperatives, the manager has a major staffing responsibility. In these larger cooperatives, key staff such as major officers or heads of departments may be selected with approval of the board because of their management functions.

Heads of departments need to work with the manager in staffing positions in their respective departments. This enables authority for staffing and responsibility for work accomplished to be coordinated.

It is important that the manager or the key staff provide employees with a job description. This provides opportunity for review of the job and relate it to the total operation. Often it is possible to jointly develop a set of objectives and goals that enables greater coordination of the cooperative's program to meet changing demand and opportunities for service to members.

3-15. Manager Responsibility

The manager sets a basis for supervising and coordinating human and physical resources by developing goals and plans to reach objectives. Through goals and short-range plans, the manager takes steps to carry out policy established by the board. These plans, including establishing budgets, serve as a guide for the financial business activities as well as services performed.

Establishing goals and plans offers opportunity for managers with imagination and desire to serve members to include their personal objectives within policy and anticipate changing member needs. These goals also provide a means of informing employees what is expected of them. Employees, accordingly, can plan programs delegated to them to meet the budgets and other goals established.

3-16. Manager Responsibility

Execution of policies established by the board of directors is the responsibility of the manager. This involves all aspects of the cooperative's day-to-day performance. The manager thus has responsibility for directing and controlling the day-to-day business activities, such as use of personnel, capital, facilities, and equipment. He is also responsible for commodities marketed, materials handled, and services provided.

As in any corporation, the manager must operate the association on a sound business basis by developing an effective business structure. In effect this requires using operating and financial budgets, and sound purchasing, marketing, service, and pricing practices. While maintaining an adequate accounting and record system in any business is important, added responsibility exists because of needed member records for determining refunds if any, and tax treatment.

3-17. Manager Responsibility

The manager has responsibility in the day-to-day operation to make best use of personnel. This requires a continuing program for appraising each job and evaluating the performance of the person filling it. An evaluation program:

— Determines how well the staff assumes and performs assigned responsibility;
— Encourages the staff to improve skills or ability; and
— Ensures best use of the staff's talents.

Performance evaluation assumes the staff can adjust to job and program requirements and have capacity for improvement. An evaluation program can encourage employees toward self-improvement when they know opportunity exists for advancement.

While employee development is a manager responsibility, the board must provide evaluation policy guidelines.

3-18. Manager Responsibility

Hired management's responsibility is derived from that responsibility entrusted by members to the board of directors. Because the manager is working with members' money, he has not only the duty to operate the cooperative efficiently but also to report regularly to directors and members.

Reports such as the operating statement are used to present accurate information at the board of directors meeting to help the board reach knowledgeable decisions. In larger

cooperatives, the manager invites key staff, such as heads of departments, to board meetings so they may report on their operations and serve as resource people.

Less detailed reports are circulated on a regular basis to members. These reports, often on a monthly basis, contain items of interest to members and may include market situation, product movement, inventory, and many other kinds of reports of member concern. These reports are often contained in newsletters, newspapers, or magazines.

Annual meetings are held as provided in the bylaws. The purpose of the annual meeting is to review the program and the business of the cooperative for the past year, elect officers, and plan and decide future activities.

Members are entitled to know all the pertinent facts concerning their organization and to receive an up-to-date progress report. Combined efforts of the manager and directors in properly presenting and intelligently discussing annual reports offer a basis of mutual understanding between management and members. After reports by the employed management staff and directors, members have the opportunity to ask questions and to make suggestions.

3-19. What Are Employees' Responsibilities?

Employees working for cooperatives need to know what cooperatives are and how they compare with other methods of doing business. Understanding cooperative purposes, objectives, operations, and their role in the community is important for employees. They are frequently called on to answer questions about their employing cooperative and cooperatives in general. Well informed employees can help improve cooperative image and understanding.

Management can inform employees about the cooperative through staff meetings, training programs, and printed materials. Many employees may be hired right out of school. Most students receive little or no cooperative education. Some cooperatives have programs through youth organizations. Some land grant universities offer courses in cooperatives. This means that while employees are responsible for understanding the purpose and objectives of cooperatives, management must pay particular attention to developing employee education and training programs.

3-20. Employee Responsibility

In many cooperatives, like other business firms, the largest operating expense is for personnel. In addition to salaries and wages paid, these costs include interviewing, hiring, training, and fringe benefits. Training and developing employees, both formal and informal, must be the result of planned conscious efforts. It is a continuing process and may include on-the-job and programmed outside training. This requires sizable investment in employees to help them become productive.

Cooperatives, like other business firms, expect fully performed duties for the invested training, compensation, and benefits provided. Cooperative managers know they must pay competitive salaries and provide comparable benefits if they expect to recruit and hold qualified employees.

While the cooperative has responsibility for recruiting and providing training situations, the employee is responsible for using these opportunities to better prepare to fully perform duties of service to members.

3-21. Employee Responsibility

In a small local cooperative, the manager maintains good relations between the cooperative organization and members. The personal contacts keep the members informed of their cooperative's activities. Immediate feedback from members is encouraged to keep the manager informed of problems, needs, and evaluation of services.

Situations may be quite different in larger cooperatives. Personnel hired by regional cooperatives may have sole responsibility for building cooperative image as they serve members. The only cooperative employees that members encounter from annual meeting to annual meeting may be the warehouseman loading supplies in the patron's truck, fieldman, truck driver, telephone operator, credit officer, cashier, or billing officer.

This means the clerical and operating employees, as representatives of the cooperative, have responsibility to understand the relationship to member-owner-patrons. They must realize the members own the cooperative, not the employee or management, and that services provided are for concerned members. Application of common sense and reason to the cooperative policy is expected by members.

Members expect employees to listen. When members complain, some adjustments may be made at the sight with a few words of reassurance, an extra step to provide satisfaction, or to see that equipment is properly performing.

Complaints concerning management should be promptly delivered to management after endeavoring to obtain adequate and correct information.

3-22. Employee Responsibility

Employees help build the cooperative's image as they serve members and the community—both at the cooperative's premises and away from them. Employees are responsible for keeping the premises clean and attractive so other businesses on the main street desire them as business neighbors. They need to learn about cooperative principles and practices to respond readily with accurate information when people ask.

They are proud that members through their cooperative offer employment to highly qualified and experienced people for the many technical and complex tasks involved in marketing, processing, purchasing, and transacting other business. As the cooperative grows, they know additional employees will be needed, new facilities will be built, and more community income will be created. This added income expands the business community, improves and builds homes, and supports and maintains community affairs and projects.

Employees, within limits of cooperative policy and like their manager, can be community boosters by taking part in church, school, or community affairs. Their efforts can positively affect the cooperative image held by members, the general public, and other businesses.

3-23. Economic Democracy In Action Requires Everybody Working Together

A cooperative is economic democracy in action. It requires everybody working together—members, directors, manager and key employees, and clerical and operating employees—to have a successful cooperative. All these persons pulling their share of the load helps the cooperative business offer opportunity for members and their communities to adjust to changing economic and social conditions.

Suggested Assignments

— Make a study and report on the four groups of people—members, directors, manager and key employees, and clerical and other operating employees—involved in the cooperative cooperating in your work experience, or in a cooperative in the community.

—Identify opportunities for employment in cooperatives in the community and procedures for applying for employment.

—Identify opportunities for member responsibilities in a cooperative where you, your parents, neighbor, or friends hold membership and determine how these responsibilities can be assumed.

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PRINCIPLES UNDERLYING COOPERATIVE FINANCING AND TAXATION

LESSON 4

Understanding your cooperatives

Objectives

— Understanding cooperative business firms need capital and how cooperative capital is attained.

— Understanding cooperatives pay taxes required by law.

4-1. Who Finances A Business?

Business needs capital for two main purposes—to acquire fixed assets and for working capital.

Three groups of people finance the business through different processes:

— Owners finance a business as investors. This capital should be sufficient to obtain fixed assets that cannot be financed on long terms at reasonable interest rates. Owners may also provide some working capital.

— Creditors as lenders finance a business. This borrowed money may come from one of many places—banks, insurance brokers, and other sources through issuance of negotiable paper secured by the owners investment.

— Customers as purchasers finance a business. The owners retain profits for reinvestment in the business from year to year.

4-2. How Do Those Who Finance The Business Benefit?

The three groups of people who finance a business do so for different reasons.

— Owners finance a business expecting a return on investment through service to other people.

— Creditors are willing to invest or lend money to the business in return for interest the owners are willing to pay.

— Customers are willing to pay owners of a business a profit to get the goods and services desired.

4-3. How Does Cooperative Financing Differ?

Cooperatives, like other business operations, need capital to get started and to provide owner-member services. Members finance their cooperatively owned business by using all the usual methods employed by other business corporations plus a few distinctive to cooperatives.

Members organize purchasing and service cooperatives to obtain goods and services for themselves. In essence, the owners are the customers or patrons. As owners, they provide the capital to start the cooperative expecting to get services in return. As patrons, they must pay for the use of the cooperative as it obtains the supplies and services for them.

Although capital needs of purchasing and service cooperatives vary according to volume of business, seasonality, type and amount of business conducted as it does for other businesses, cooperatives' equity financing sources are more limited. Outside capital sources are limited because interest payments and stock dividends paid by cooperatives are limited by law.

Returns on member capital are limited to 8 percent per annum by many State statutes and the Capper-Volstead Act. Banks for Cooperatives require that dividends on a cooperative's stock or membership capital be limited to 10 percent a year for cooperatives to be eligible for loans if voting is on other than one-member, one vote basis.

Outside capital investment is limited also because of the noncumulative stock value, and the absence of speculative trading.

The conclusion is that member-owners of purchasing and service cooperatives bear substantially greater burden for providing capital for their cooperative business than do owners of other businesses.

4-4. How Does Cooperative Financing Differ?

Marketing cooperative financing, like production and service financing, also differs from other business financing.

Members establish their cooperative to obtain a market for products they produce. Again, the owners are the users but in a different sense. As owners, they provide the capital to start the cooperative to obtain the marketing services needed. As marketing patrons, they must pay for the use of the cooperative as it assembles, processes and sells their raw and processed products.

As in purchasing or service cooperatives, marketing cooperative equity financing sources are limited because interest payments and stock dividends paid by cooperatives are limited by law.

However, the people who purchase the farmer-member products as customers are consumers. They are willing to pay the cooperative for the goods and services they offer. As in any business, these consumer customers indirectly pay the member-owners of the cooperative business a profit to get the goods and services desired. Member-owners may decide to reinvest some of this profit in the cooperative from year to year.

The limited return on member capital, discourages investment in cooperative marketing businesses. Investment in cooperative business stock is further discouraged by its noncumulative value that results in no speculative stock trading.

The conclusion is that member-owners of marketing cooperatives, as in production and service cooperatives, bear substantially greater burden for providing capital than do owners of other businesses.

4-5. What Capital Is Needed?

Cooperatives like any business need two kinds of capital—fixed capital and operating capital.

Fixed capital is money to buy such things as land, buildings, and equipment for buildings and for transportation.

Operating capital is the money required to keep the business going or operating. These requirements include paying employees, buying operating supplies such as packing cartons and office supplies, paying for electricity or other utilities, advancing members money on products marketed for them, building adequate inventories, providing services and many more items.

Total capital needed by a cooperative depends on such factors as volume of business, type of service it provides, kind of physical facilties needed, nature of competition it faces, seasonality of commodities handled, and degree of risk it takes in the day-to-day conduct of its business. Whatever the total amount of capital, it normally is related to the number of members and volume of business.

4-6. How Do Members Provide Equity Capital?

Equity or risk capital provides the necessary elements of ownership and control that any business must have. It serves as a buffer for creditors to absorb operating losses and shrinkage in assets. In a cooperative the members must provide the equity capital.

Common stock is generally used by cooperatives organized with capital stock to indicate membership or voting stock. Some nonstock cooperatives issue membership certificates to qualified farmers to denote membership or voting rights. Regardless of the type of certificate used, capital raised from sale of voting stock is of nominal importance. To obtain additional equity capital many cooperatives issue one or more classes of nonvoting capital stock.

Members and patrons provide their cooperative with equity capital in four ways:

— Purchasing capital stock or other securities.

— Investing a portion of the net margins.

— Contributing capital through deductions from sales proceeds in the form of per-unit capital retains.

— Contributing base capital in proportion to historical use of facilities and services furnished.

The methods used in obtaining equity capital vary by type of cooperative operation. While members in most cooperatives purchase capital stock or other type securities, they usually use at least one other method.

4-7. How Do Members Provide Continuing Equity Capital In Supply And Service Cooperatives?

Members in supply and service cooperatives invest a portion of their patronage allocations from net margins from purchases in addition to purchased stock or securities as equity capital. The patronage allocations invested are net margins realized in cooperative operations in obtaining the supplies for members or in providing services to members. These patronage refunds allocated as equity capital are often returned to the member patrons as deferred payments on a revolving fund basis. Repayment goes first to member patrons whose contributions are the oldest in the revolving fund.

The revolving fund plan allows members to provide equity capital in their cooperative in proportion to the amount of business they do. It provides for current patron investment and an orderly process of withdrawing the members' investment without impairing the total cooperative capital structure. It also provides the cooperative business flexibility to meet changing conditions that influence financial needs. Successful operation of retain or allocation of patronage refund in a revolving capital equity plan requires member understanding of their financing obligations.

4-8. How Do Members Provide Continuing Equity Capital In Marketing Cooperatives?

Outright sale of equity capital stock is used primarily by larger marketing cooperatives, especially multipurpose and diversified marketing organizations. As in supply cooperatives, members may invest a portion of their patronage allocation from net margins.

Members in most marketing cooperatives invest their per-unit retains as additions to purchased stock or securities as equity capital. Per-unit capital retains are those investments made by member patrons in compliance with a bylaw provision or membership agreement. The agreement authorized the cooperative to make a specified deduction for equity capital from advances to member-patrons based on physical unit marketed or processed and marketed (hundredweight, bushels, cases, cartons, dozens, etc.) or a percent of the sales return to member patrons.

Acquiring equity capital varies widely for commodity groups in marketing cooperatives. For example, grain marketing cooperatives acquire about one percent of their equity capital by per-unit capital retains from sales with patrons. Fruit and vegetable cooperatives in contrast may acquire as high as $2 out of $3 of equity capital by this method.

As in supply and service cooperatives, successful per-unit retain financing on a revolving basis in marketing cooperatives requires member education and understanding of their financing obligations.

4-9. How Do Members Provide Continuing Equity Capital On A Permanent, Non-Revolving Basis?

Members of some cooperatives, more often marketing cooperatives, provide continuing equity capital on a permanent, nonrevolving basis to operate the business. This modification of the traditional revolving fund plan is called base capital financing.

Member-patrons, usually by bylaw provision, make capital contributions at the beginning of the year in proportion to their respective use of facilities and services. The total amount of cooperative capital required is determined from time to time by the board of directors. The proportionate share of such amount of capital provided by each member-patron is based on the volume or value of products marketed through the cooperative during a representative period of 5 or 10 years.

When the capital share of a member-patron for any fiscal year exceeds the capital credits attributed to him at the beginning of the year, the amount of the excess is assessed to the member-patrons. This amount may be withheld or retained from the proceeds of sales of member products, patronage dividends, or any other amount due the member-patron. If the member's share for a given year is less than the capital credits attributed to

him at the beginning of the year, the difference may be refunded at the time and in the manner determined by the board of directors. The cooperative must treat all members alike for any one fiscal year.

Cooperatives using base capital financing keep their membership up to date. Those who do not use the cooperative are rotated out of the cooperative thus keeping membership current. Those who use the services most have the greatest capital investment.

4-10. Where Does A Cooperative Get Borrowed Capital?

Cooperatives need more capital than expedient for most members to provide. This capital must be borrowed using member equity capital as collateral. Members' share of total capital must be large enough to invite credit sources for additional capital when needed. These loans may be long-term credit for facilities; intermediate-term credit for operating capital, or short-term commodity loans for marketing cooperatives.

Cooperatives use the usual sources of credit available to all business organizations plus some special cooperative sources.

— Members may lend additional capital through purchase of securities for which they are paid limited interest or dividend. Members may borrow capital against personal securities through Production Credit Associations or Federal Land Bank Associations for their initial investment to get the cooperative started or to finance their commodities until marketed through their cooperative.

— Nonmember investors such as other cooperatives; marketing and supply companies; individuals, firms, and organizations interested in the cooperative's limited dividends, or in its welfare and success in the community are sources of borrowed capital.

— Banks for Cooperatives, organized under the Farm Credit Act of 1933, provide a permanent, specialized credit and business service at cost on a constructive basis for farmer cooperatives.

A farmer cooperative becomes a member of a Bank for Cooperatives by borrowing from it. When it does, the association invests in the capital stock of the bank on a continuing basis in proportion to the interest it pays on its loans.

To be eligible to borrow from a Bank for Cooperatives, a cooperative must be an association in which farmers act together in performing one or more of the following:

1. Processing, preparing for market, handling, or marketing farm products.
2. Purchasing, testing, grading, processing, distributing, or furnishing farm supplies.
3. Furnishing farm business services.

It is also necessary that an association be operated for the mutual benefit of its members and that it does at least as much business with members as with nonmembers.

Along with making loans, the Banks for Cooperatives offer counseling services to cooperatives. The Banks have experienced personnel available for this added assistance.

— Commercial banks are a source of borrowed capital as for any type business.

— Various other lending institutions and as insurance companies, pension funds, and others may also invest in a cooperative.

4-11. What Are Some Special Sources Of Borrowed Capital?

— Rural Electrification Administration (REA) in the U.S. Department of Agriculture is a recognized specialized source of loan funds. REA loans are made: (l) To provide

electric service in rural areas through construction of power lines and related facilities; and (2) to finance the improvement and extension of telephone lines in rural areas.

REA guarantees loans to facilitate obtaining financing for large-scale electric and telephone facilities from non-REA sources. Guarantees are considered if such loans could have been made by REA and may be made concurrently with an REA loan.

— Rural electric cooperatives also have their own self help institution, the National Rural Utilities Cooperative Finance Corporation (CFC) as a supplementary financing source. Under a form of common mortgage agreement, REA gives loans made by CFC and other nongovernmental lenders equal status with those of REA on a prorata basis.

REA also offers its borrowers technical assistance in engineering, accounting, and management development.

— Rural telephone cooperatives operate under the same general cooperative principles as rural electric cooperatives. They are located in 31 States and obtain funds from REA and from the Rural Telephone Bank—an agency of the U.S. Department of Agriculture established in 1971 to provide supplemental financing for telephone systems. Bank loans are being made for the same purposes as loans made by REA but bear interest at the rate consistent with the Bank's cost of money.

Other sources of Government credit to cooperative and other business organizations change as programs change. Up-to-date Federal loan program assistance available is listed in a Catalogue of Federal Domestic Assistance compiled for the Executive Office of the President, Office of Management and Budget. It is available through Superintendent of Documents, Government Printing Office, Washington, D.C. 20402 or may be found in libraries under Library of Congress No. 74-600118.

4-12. How Do Tax Regulations Apply To Cooperatives?

Contrary to beliefs, confusion, and misunderstanding of many people, cooperatives are taxed. Cooperatives pay all taxes required by law to all levels of Government. This requires extensive bookkeeping and requires capital to pay these taxes. Taxes co-ops pay include:

Sales - collected from everyone unless exempt as food and drugs in some States.

Payroll - employer's share of social security taxes.

Franchise and license - for the right to conduct business in a State or locality.

Gasoline - for use in trucks and automobiles for business purposes.

Real estate - real property, land, and buildings.

Personal property - office furniture, inventory, equipment, and machinery.

Excise - special tax on manufacture or sale of certain products or items—tires, tobacco, and others.

State income - a tax on the taxable income of corporations, including cooperative corporations, except for some specific exemptions or exclusions as assessed in most States.

Federal income - a tax on the taxable income of corporations, including cooperative corporations except for some specific exemptions or exclusions.

4-13. What Is The Principle Of Federal Tax Law For Any Firm Operating On A Cooperative Basis?

Today's Federal tax law preserves the right of any business whether chartered as a cooperative or not to establish bylaws to operate and act as a cooperative. These tax laws preserve the principle of a single tax on net income produced through cooperative-ori-

ented business activities. The federal income tax must be paid on net margins by either the cooperative or the member. If the net margin goes to the member as a patronage refund, then the refund must be listed as income on the member's income tax form for tax purposes.

Businesses operating on a cooperative basis must keep extensive records and adhere to strict requirements as to the form in which they handle capital retains and distribute patronage refunds.

4-14. What Is Meant By "Operating On A Cooperative Basis"?

There are two major requirements for operating on a cooperative basis.

First, more than 50 percent of the association's business transactions must be conducted with members. In a farmer cooperative, this means the dollar volume of products marketed, supplies purchased, and services provided for members must exceed 50 percent of the total dollar volume of products sold, supplies purchased, and services provided for nonmembers.

Second, the business must refund net margins in proportion to patronage. The 1962 law defines patronage dividends as refunds that are computed on the basis of the quantity or value of business done with patrons, made pursuant to a contractual obligation that was in effect before any transaction took place with patrons, and which were determined by reference to the net margins generated by the cooperative from business with patrons.

4-15. Where Is Information Describing Cooperative Tax Treatment?

Cooperative tax treatment information is described in Section 521 Subchapter T, IRS Code. It applies to all farmer cooperatives and certain other corporations operating on a cooperative basis.

In the process of conforming with the law, a number of alternatives are provided that cooperatives must evaluate and on which management decisions must be made.

A major alternative a farmer cooperative faces is whether to operate in compliance with the requirements of Section 521 of the Internal Revenue Act of 1954 as a so-called "income tax exempt" association; or whether to operate as a nonexempt organization by not meeting the requirements of Section 521.

4-16. What Requirements Must Business Fulfill To Have "Cooperative" Tax Status?

The law prescribes precise rules on the circumstances under which business corporations may use patronage refunds to reduce their gross income for tax purposes.

Records are generally used by management to keep them informed of conditions in the business. However, for a business to attain cooperative tax status, transactions with each member-patron must be recorded on a ticket and transferred to the patronage volume ledger. The patronage volume records are needed to allocate and distribute the net margins at the end of the year. The records are useful in fulfilling requirements for "cooperative" tax status because the IRS code requires that cooperatives maintain permanent patronage and equity interest records for each member.

The net margin allocated on a patronage basis must also meet IRS code requirements. At least 20 percent of the patronage refund must be paid in cash with the remaining portion in property of a kind on which a current value can be placed. The statutes

call this "qualified written notices of allocation," or in the case of marketing cooperative capital retains, "qualified per-unit retain certificates." The statutes also require the refund must be paid within 8 ½ months after the close of the cooperative's fiscal year.

If the business does not comply with these rules, it does not attain cooperative tax status. It cannot exclude patronage refunds from taxable income and thus pays the tax on all net margins at the corporate rate.

4-17. What Requirements Can A Farmer Cooperative Fulfill To Gain "Limited" Tax Exemption?

To obtain limited tax exemption or so-called "income tax exempt" status, farmer cooperatives must file for a letter of exemption with the Internal Revenue Service. To obtain this letter of exemption, additional requirements must be fulfilled by the cooperative.

Exemption is denied any association whose dollar volume of products marketed or supplies and equipment purchased for nonmembers or nonproducers exceeds 15 percent of total volume.

The other major requirement, aside from qualifying as a farmer cooperative that requires following specified business procedures, is that nonmember patrons must be treated the same as member patrons. This is why some cooperatives may pay patronage refunds to urban or suburban resident purchasers.

4-18. When A Farmer Cooperative Qualifies For Exemption, What Other Tax Deductions Are Permitted?

Farmer cooperatives qualifying for so-called income "tax exempt status" are permitted certain other tax deductions.

Qualifying organizations are allowed to deduct from gross income amounts of nonpatronage income paid out on a patronage basis, if distributed within 8½ months after the end of the business year in which it was derived. This deduction includes all nonpatronage income such as business with the United States, rents received on property, and interest received from deposits or investments provided it is paid out on a patronage basis by the specified time.

In computing the taxable income, qualifying organizations are allowed to deduct from gross income amounts paid as dividends during the year on its capital stock. This is construed to include any form of return on all genuine capital interests.

4-19. What Reporting Procedures Must A Cooperative And Its Members Follow Concerning The Tax Treatment Of Patronage Refunds?

Farmer cooperative corporations, the same as other corporations, must file an income tax statement. Cooperatives deduct from their taxable income the amount of patronage refund paid that qualifies under the Internal Revenue Code. The so-called "income tax exempt" farmer cooperatives include the amounts paid out as dividends on capital stock and nonpatronage income as deductions which nonexempt cooperatives do not.

Patrons receiving the patronage refund report the entire refund as ordinary income. This means the cash refund and the noncash certificates must be listed as income to the member on their income tax form.

4-20. Summary

Member-owners of a cooperative corporation must bear a greater burden for financing the association than do owners of other corporate business. The member-owners are also the patrons of purchasing and service cooperatives and thus assume a dual role of responsibility.

Farmer cooperatives must meet special Internal Revenue Code requirements to gain limited tax exemption or so-called "income tax exempt" status and treatment. These requirements limit nonmember, nonproducer business to not more than 15 percent and provide that nonmembers and members be treated alike.

The Internal Revenue Service Code provides farmer cooperatives alternate methods of handling net margins. This includes the choice of whether to qualify for the so-called "income tax exempt" status.

The Internal Revenue Service code sets down precise rules on circumstances under which farmer cooperatives, nonexempt and exempt, may use patronage refunds to reduce their gross income for tax purposes. If the cooperative does not comply with the rules, it cannot exclude patronage refunds from taxable income and is subject to taxation on them at the corporate rate. Even though the cooperative may comply with the rules, either the cooperative must assume the tax liability of the patronage refund or the member-patron must comply by reporting the entire refund as ordinary income.

Contrary to beliefs many people seem to hold, cooperatives pay all other taxes as required by law on the same basis as do other business corporations.

Suggested Assignments

— Determine how your district Banks for Cooperatives work with members and cooperatives in your community on financial matters.

— Make a study and report on the methods used in financing the cooperative cooperating in your work experience, or a cooperative in your community.

— Make a study and report on taxes and licenses paid by the cooperative cooperating in your work experience, or by a cooperative in your community.

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What Are Cooperatives? C. H. Kirkman, Jr., Cooperative Information Report 11. Revised 1978. 9 pp. (Also in Spanish).

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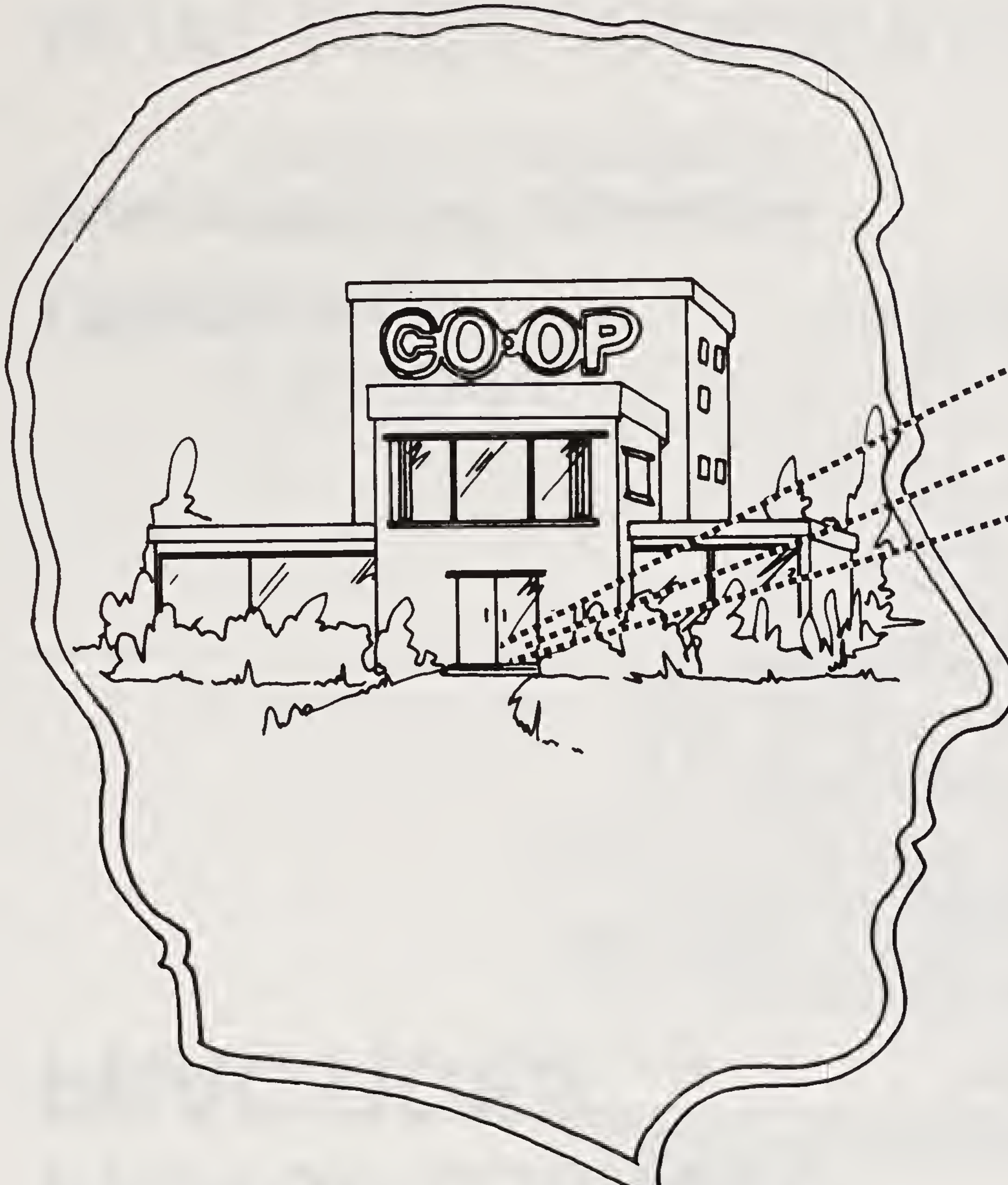
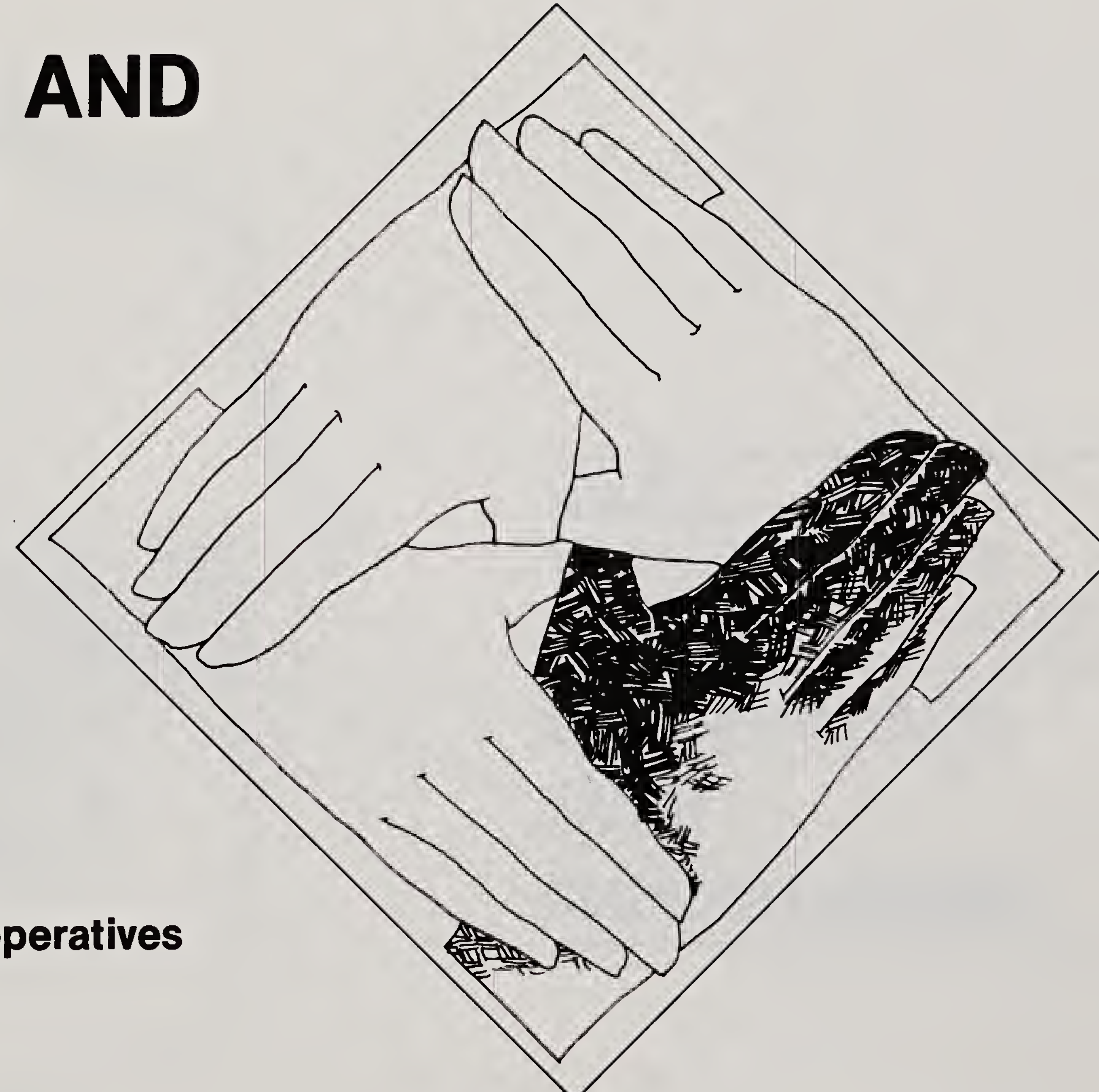
For copies, write Economics, Statistics, and Cooperatives Service, U. S. Department of Agriculture, Washington, D.C. 20250.



UNDERSTANDING YOUR COOPERATIVES

ECONOMICS, STATISTICS, AND COOPERATIVES SERVICE

PRINCIPLES AND PRACTICES



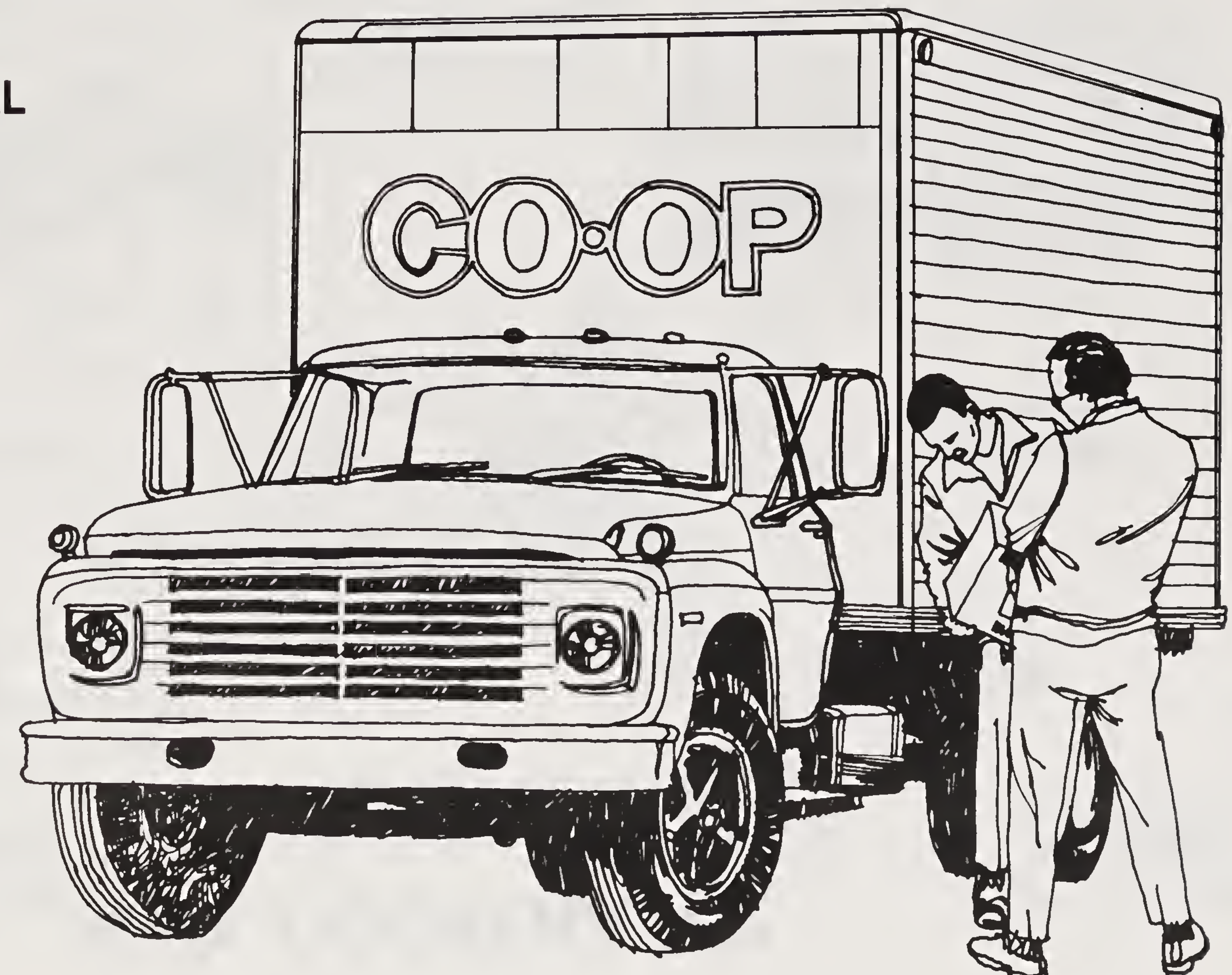
LESSON 1

Understanding your cooperatives

WHAT DOES COOPERATION MEAN?

JOINING OF RESOURCES

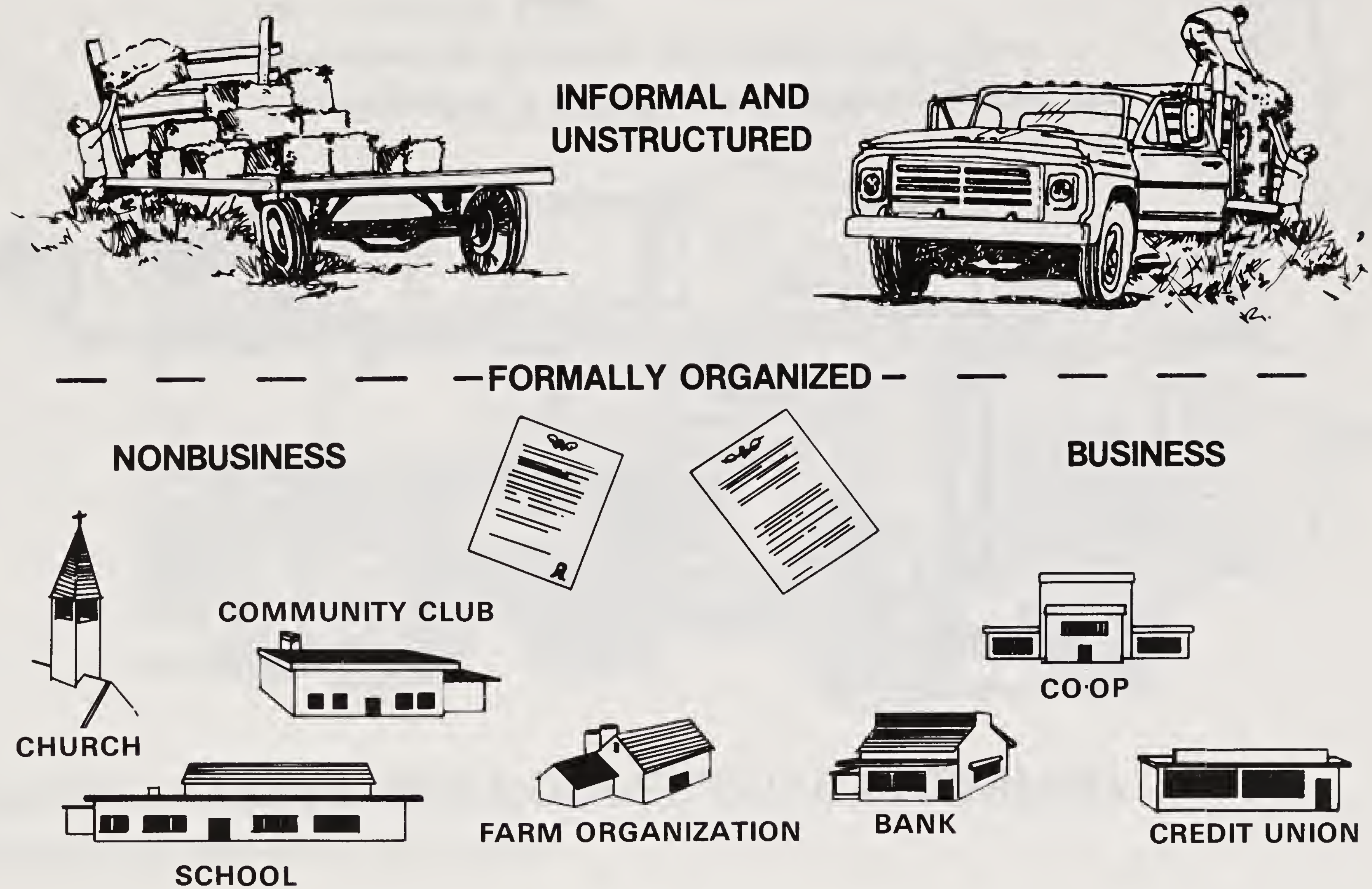
- PHYSICAL
- MENTAL
- MATERIAL



WHY COOPERATE?

- **FOR MUTUAL BENEFIT**

WHAT ARE TWO BASIC TYPES OF COOPERATION?



WHAT IS A COOPERATIVE BUSINESS?

A cooperative is a business voluntarily owned and controlled by its users and operated for them on a nonprofit basis.

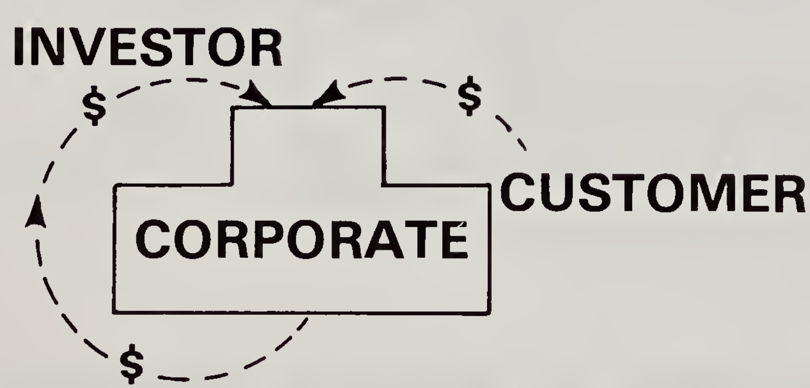
WHAT DOES A COOPERATIVE DO?

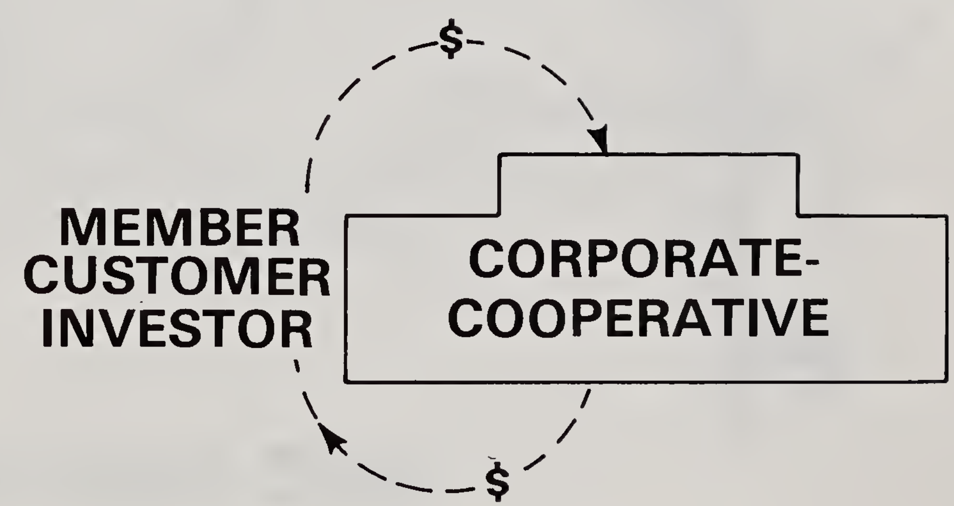
PROVIDES ITS USER-OWNERS GOODS AND SERVICES AT COST

WHERE DOES A COOPERATIVE FIT IN THE AMERICAN PRIVATE COMPETITIVE ENTERPRISE SYSTEM?

TYPES OF BUSINESSES:

INDIVIDUAL | PARTNERSHIP | CORPORATE





WHAT ARE THE FEATURES OF THE METHODS OF DOING BUSINESS?

FEATURES COMPARED	TYPES OF BUSINESS			
			CORPORATION	
	INDIVIDUAL	PARTNERSHIP	INVESTOR-ORIENTED	COOPERATIVE
1. Who uses the services?	Nonowner customers	Generally nonowner customers	Generally nonowner customers	Chiefly the owner patrons
2. Who owns the business?	The individual	The partners	The stockholders	The member-patrons
3. Who votes?	None Necessary	The partners	Common stock-holders	The member-patrons[1]
4. How is voting done?	None Necessary	Usually by partners' share in capital	By shares of common stock	Usually one-member, one-vote
5. Who determines policies?	The individual	The partners	Common stock-holders and directors	The member-patrons and directors
6. Are returns on ownership capital limited?	No	No	No	Yes—8% or less (usually less, if any)[1]
7. Who gets the operating proceeds?	The individual	The partners in proportion to interest in business	The stockholders in proportion to stock held	The patrons on a patronage basis[1]

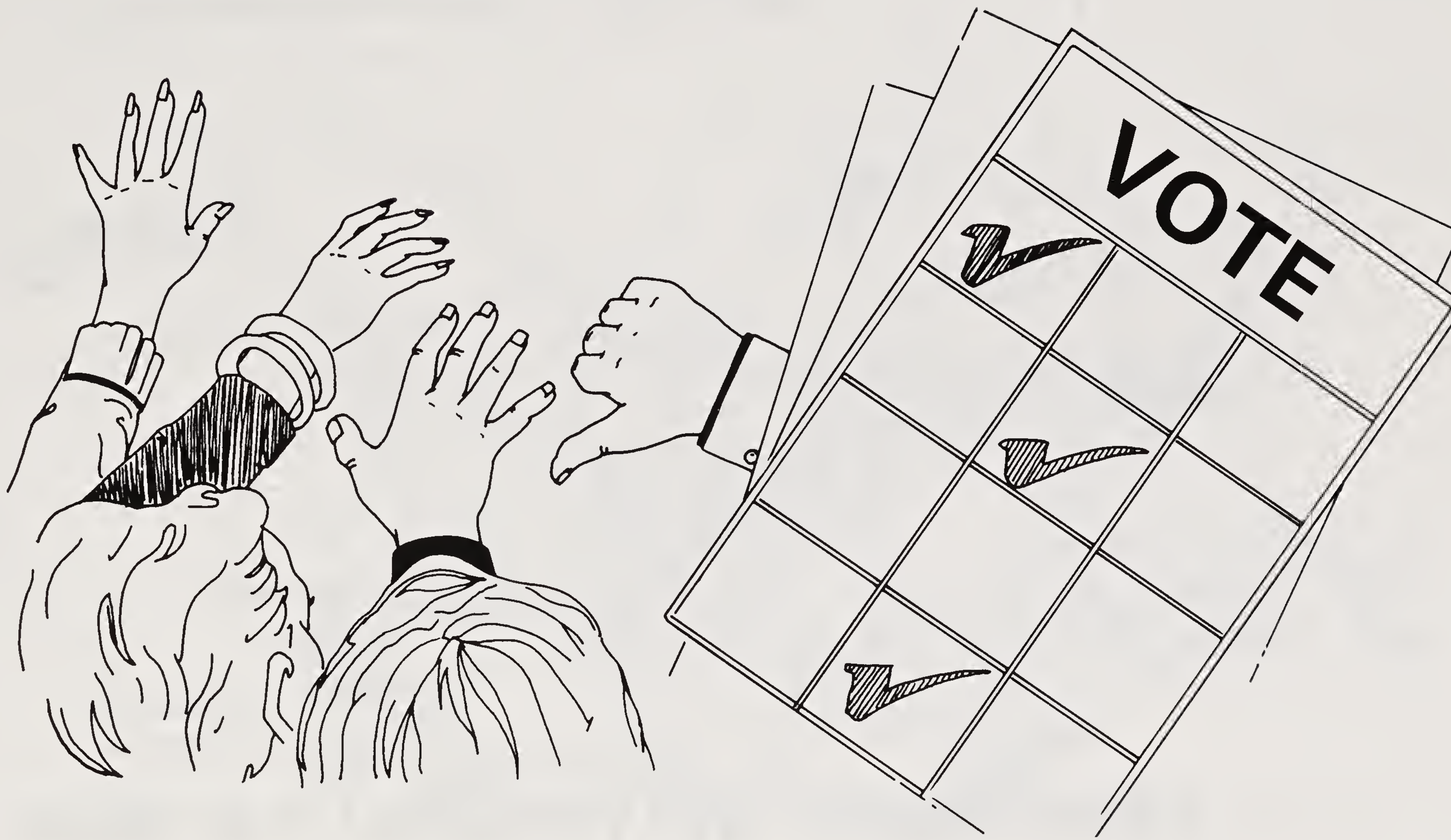
[1]Basis cooperative principles.

HOW IS A COOPERATIVE LIKE OTHER BUSINESSES?

- physical appearance
- performs similar functions
- operates on sound business practices

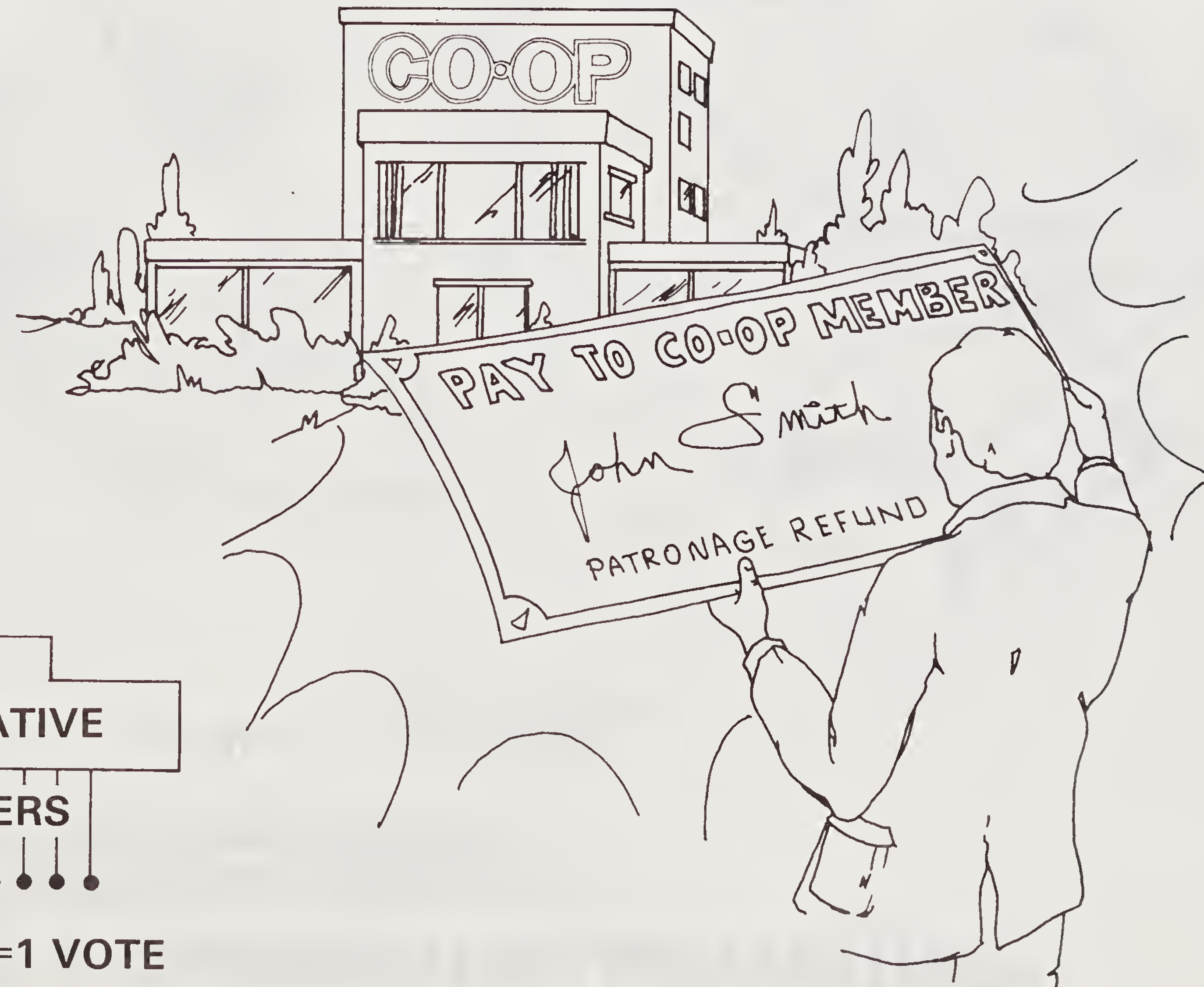
HOW IS A COOPERATIVE DISTINCTIVE?

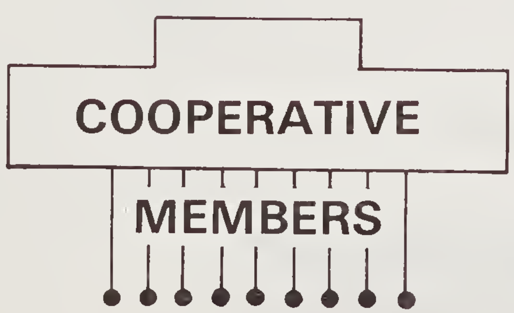
- DEMOCRATICALLY CONTROLLED —
  VOLUNTARY PARTICIPATION



HOW IS A COOPERATIVE DISTINCTIVE?

- DEMOCRATICALLY CONTROLLED
- **SERVICE AT COST**



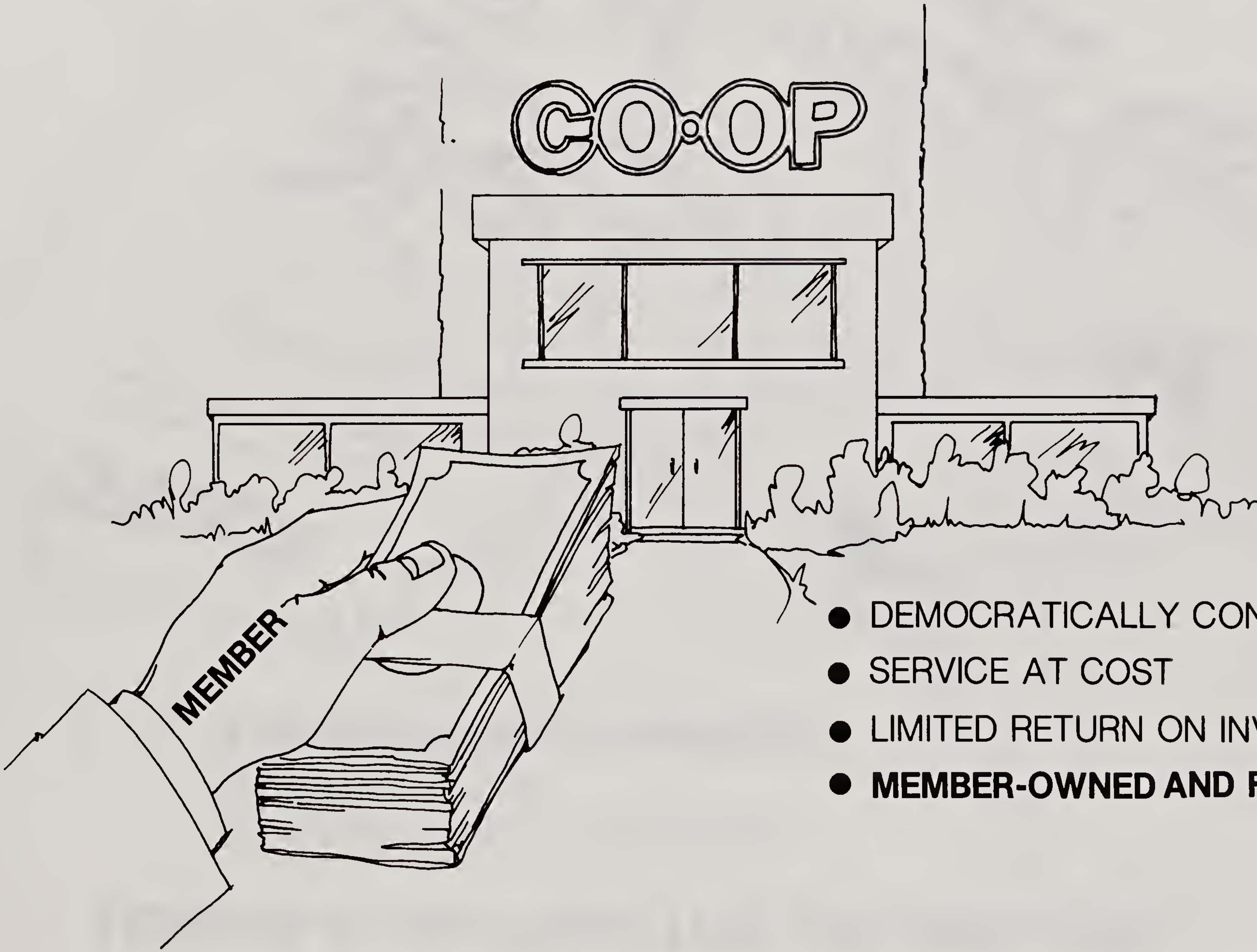


1 MEMBER=1 VOTE

HOW IS A COOPERATIVE DISTINCTIVE?

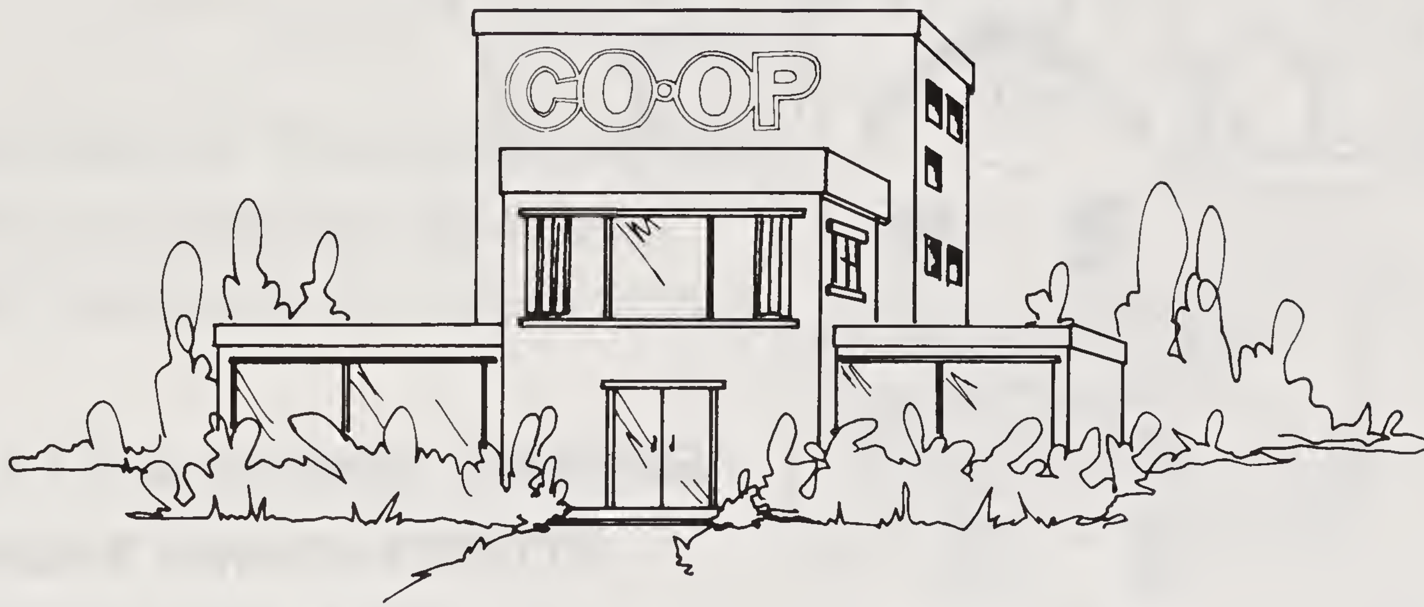
- DEMOCRATICALLY CONTROLLED
- SERVICE AT COST
- **LIMITED RETURNS ON INVESTMENT**

HOW IS A COOPERATIVE DISTINCTIVE?



- DEMOCRATICALLY CONTROLLED
- SERVICE AT COST
- LIMITED RETURN ON INVESTMENT
- **MEMBER-OWNED AND FINANCED**

HOW IS A COOPERATIVE DISTINCTIVE?



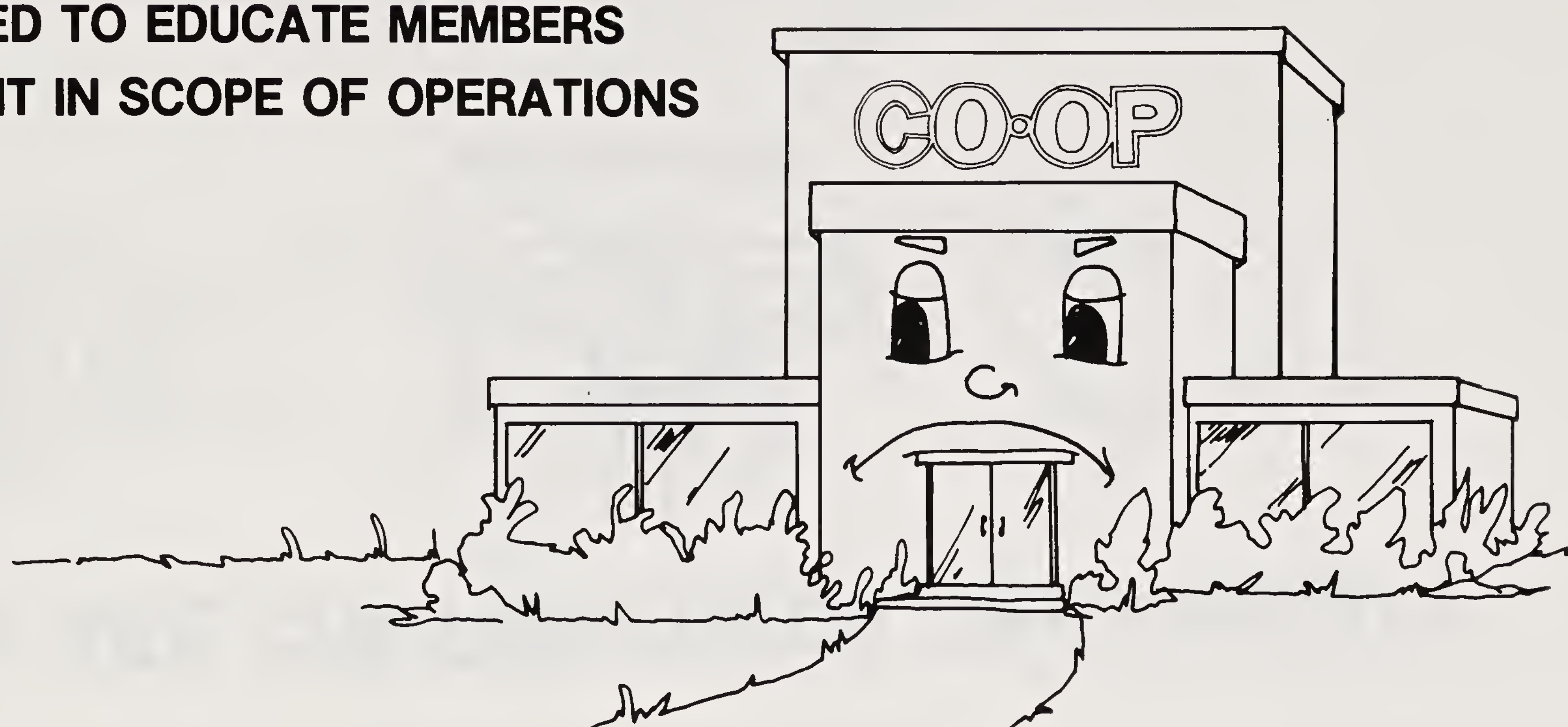
- DEMOCRATICALLY CONTROLLED
- SERVICE AT COST
- LIMITED RETURN ON INVESTMENT
- MEMBER OWNED AND FINANCED
- **OPERATIONS ARE LIMITED**

WHAT ARE THE ADVANTAGES OF A COOPERATIVE?

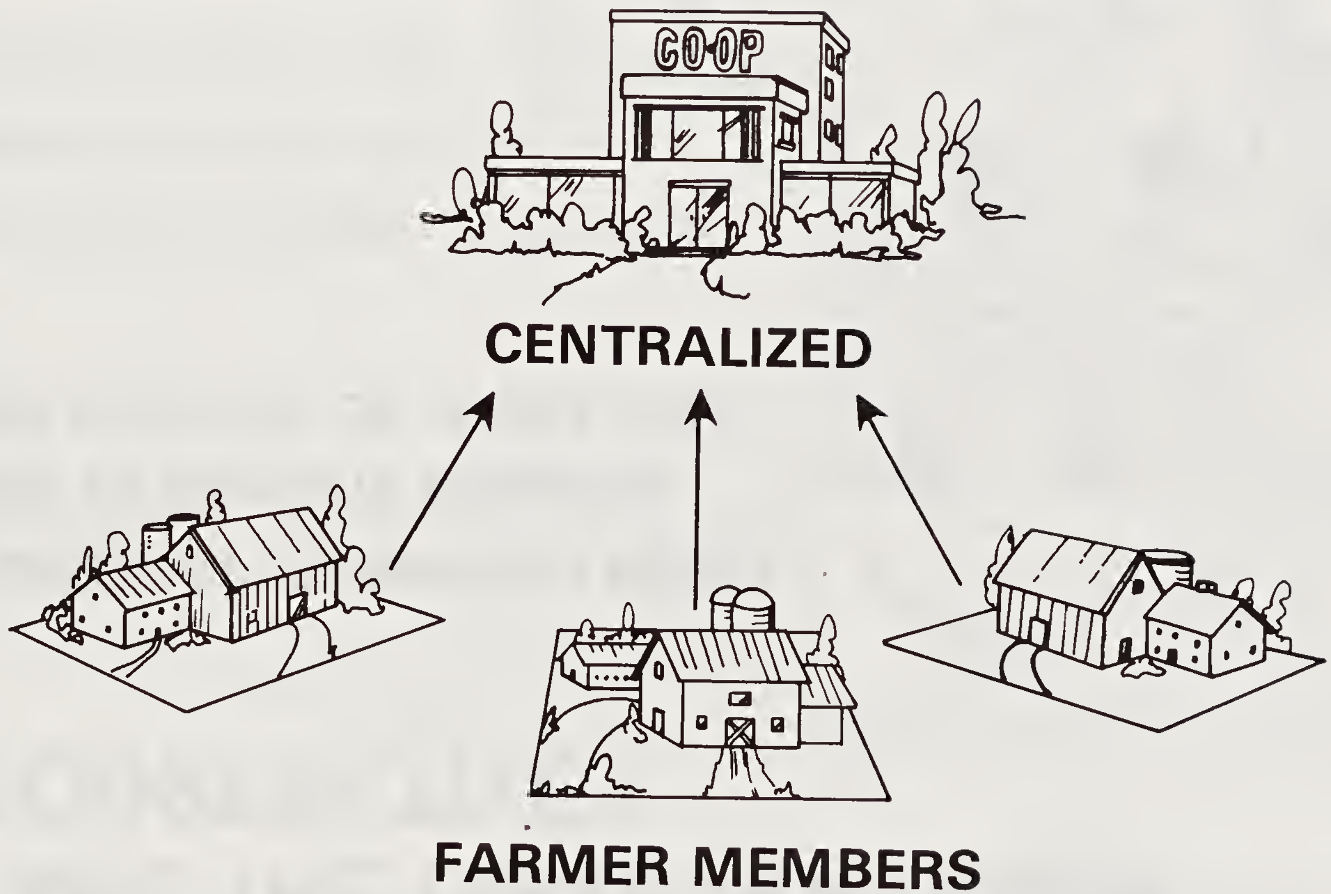
- BENEFITS TIED TO USE
- CONTROL SHARED EQUALLY
- SAFE FROM OUTSIDE 'TAKEOVER'

WHAT ARE THE DISADVANTAGES OF A COOPERATIVE?

- SOURCES OF FINANCING LIMITED
- NEED TO EDUCATE MEMBERS
- LIMIT IN SCOPE OF OPERATIONS



HOW ARE COOPERATIVES ORGANIZED?



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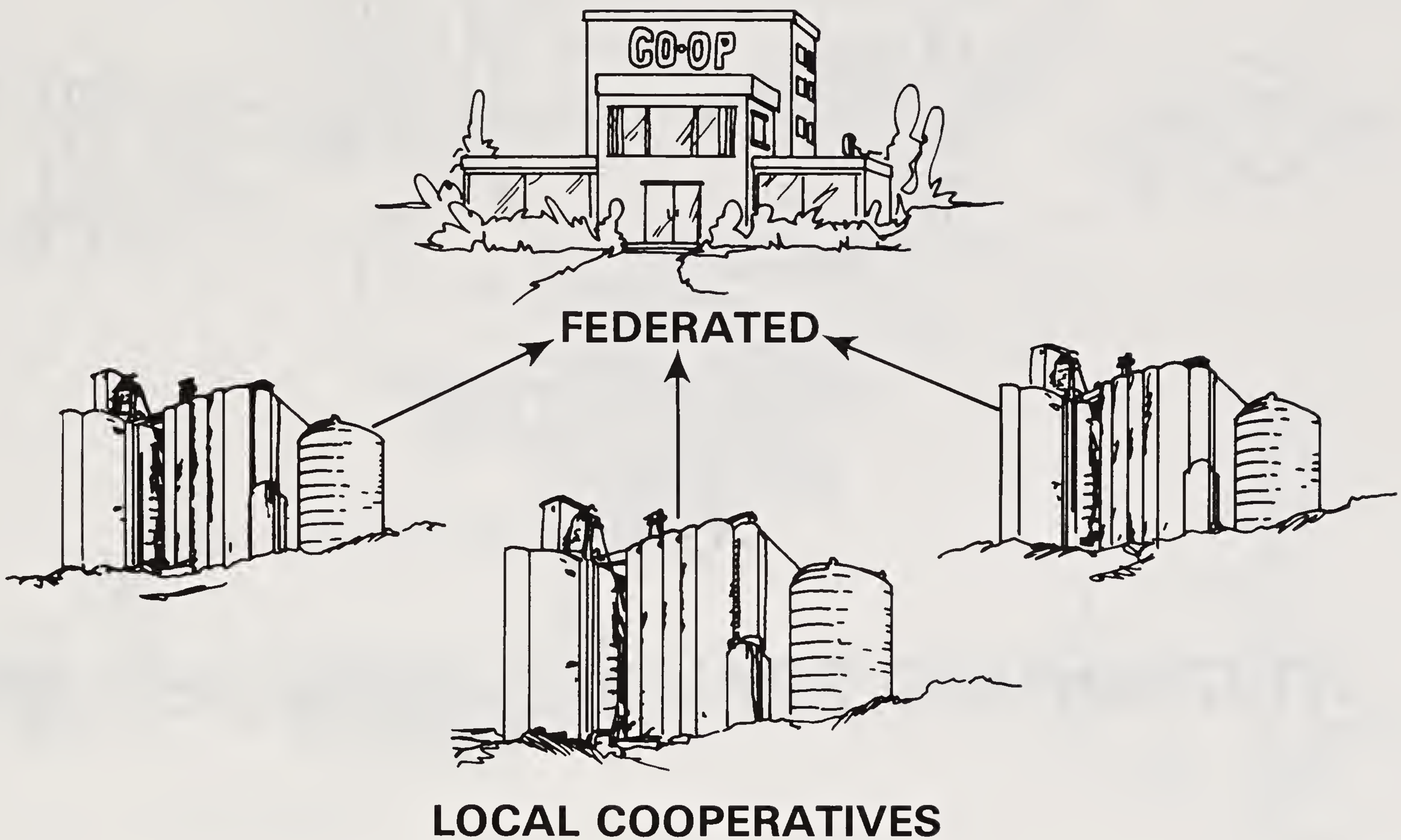

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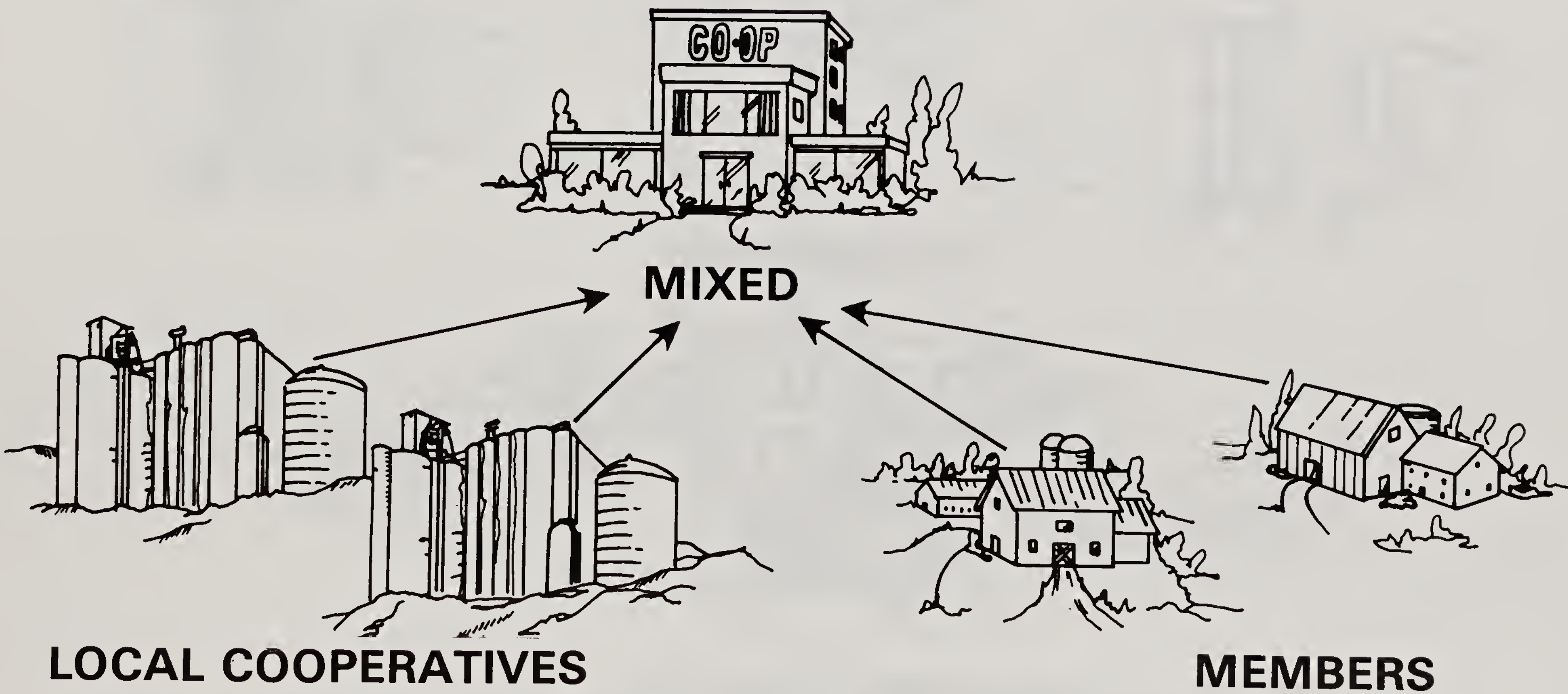
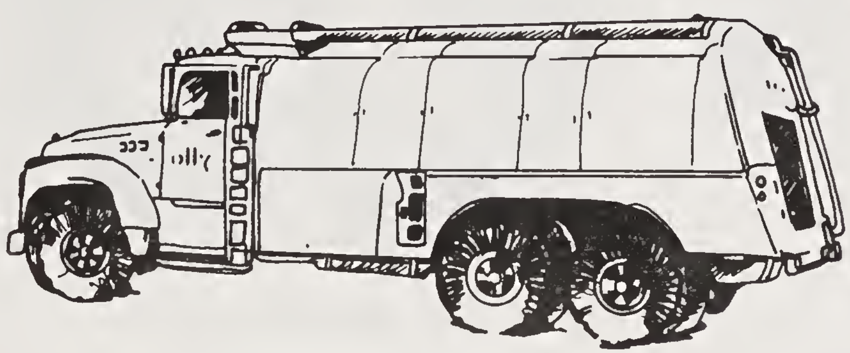
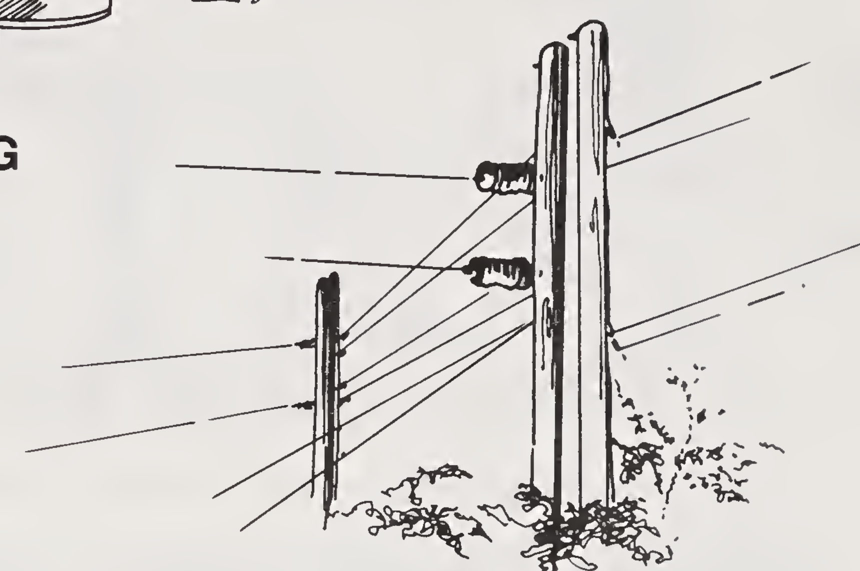


WHAT TYPES OF COOPERATIVES ARE OPERATING?

MARKETING

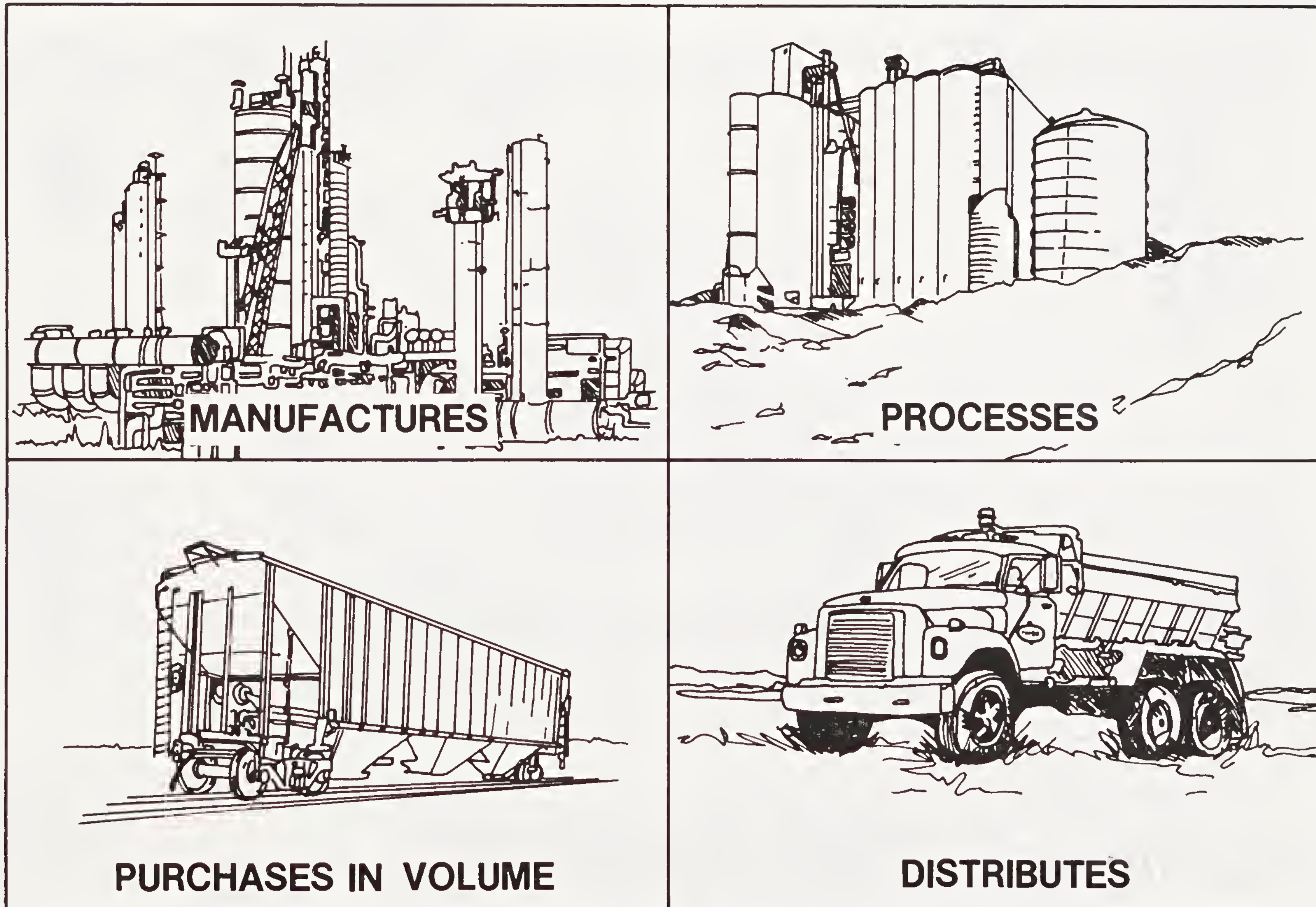


PURCHASING

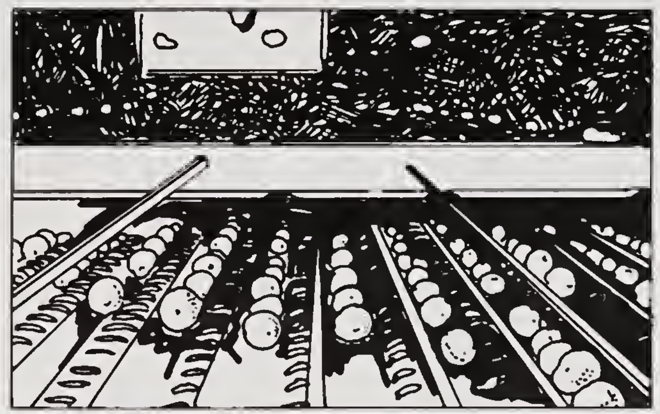


SERVICE

WHAT DOES A PURCHASING COOPERATIVE DO?



WHAT DOES A MARKETING COOPERATIVE DO?

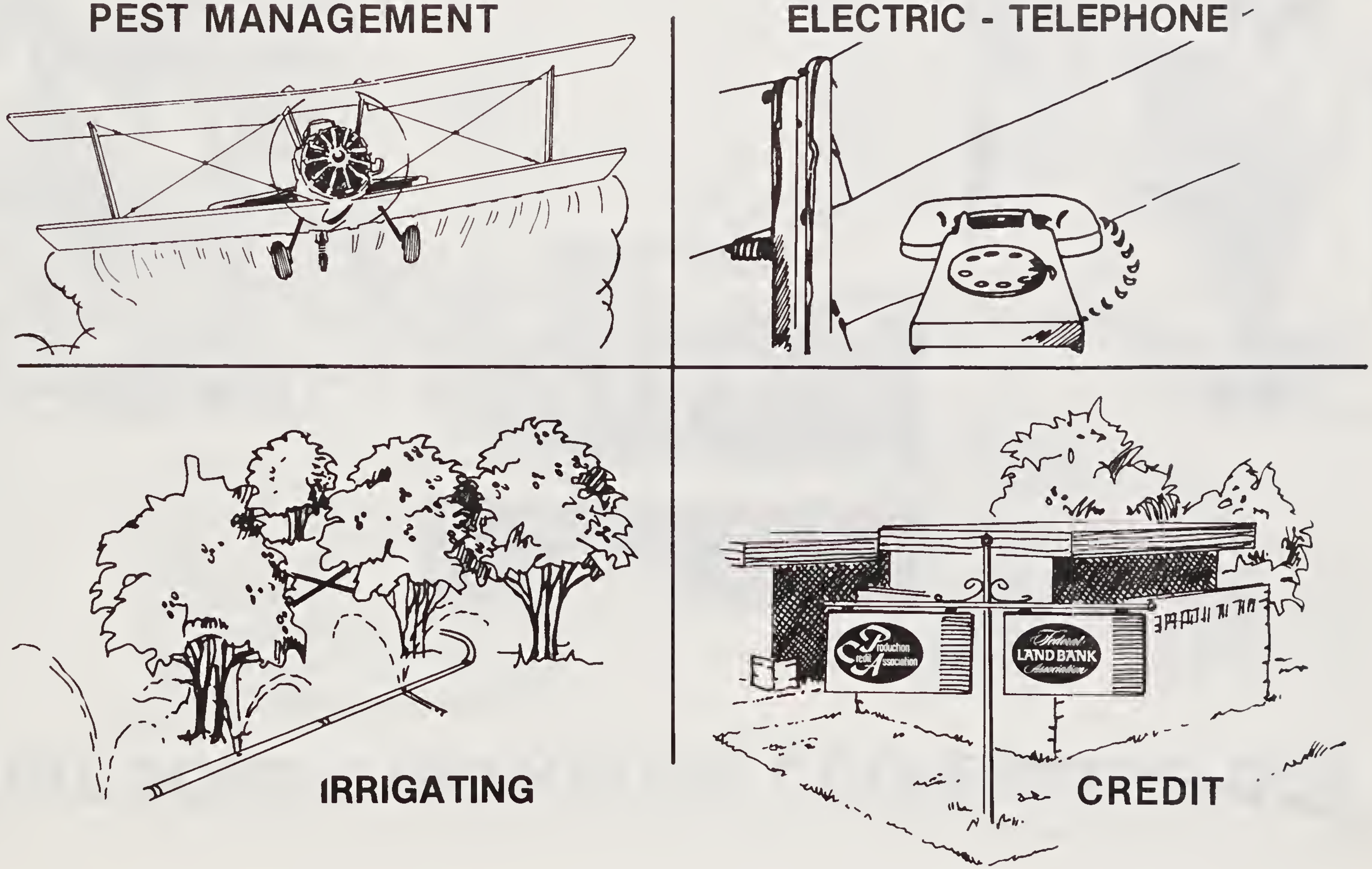


PROCESSES

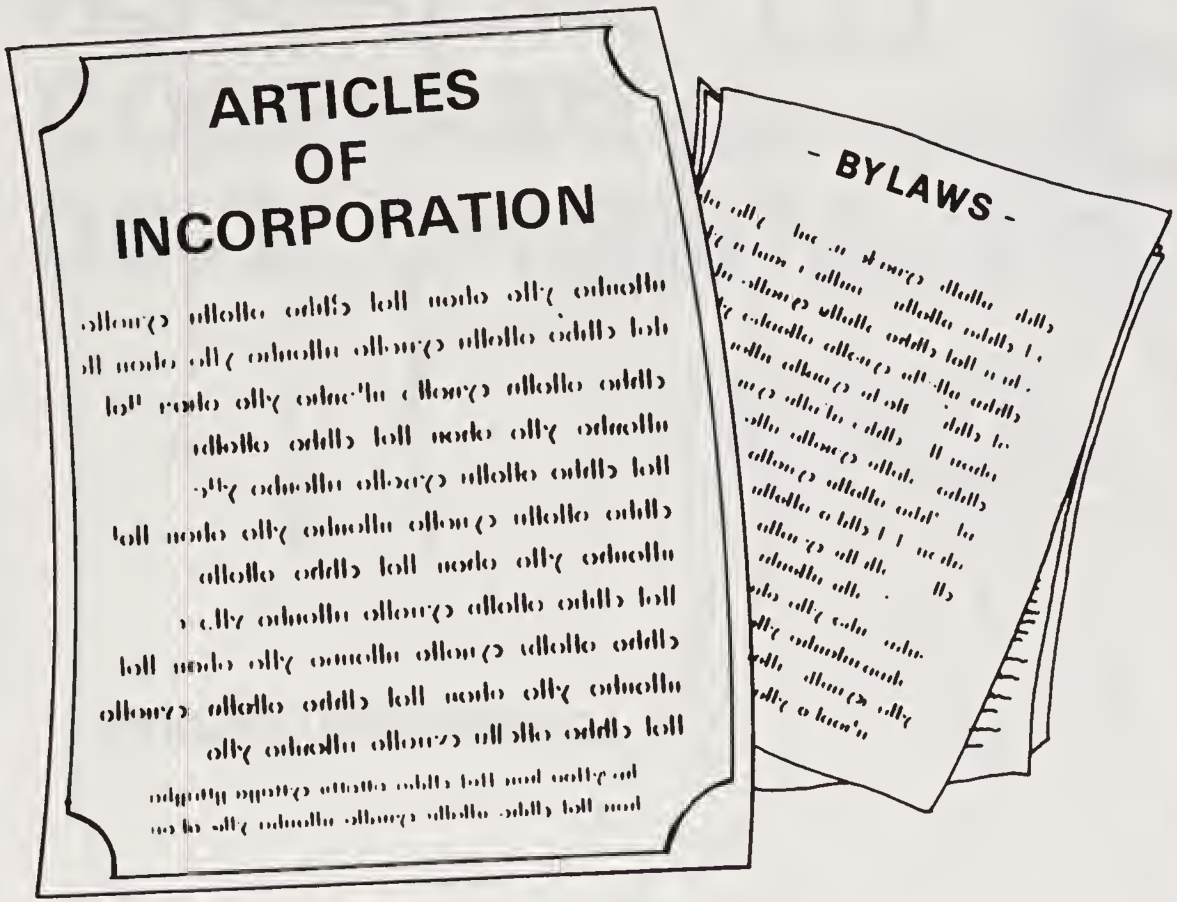
ASSEMBLES

SELLS RAW AND
PROCESSED PRODUCT

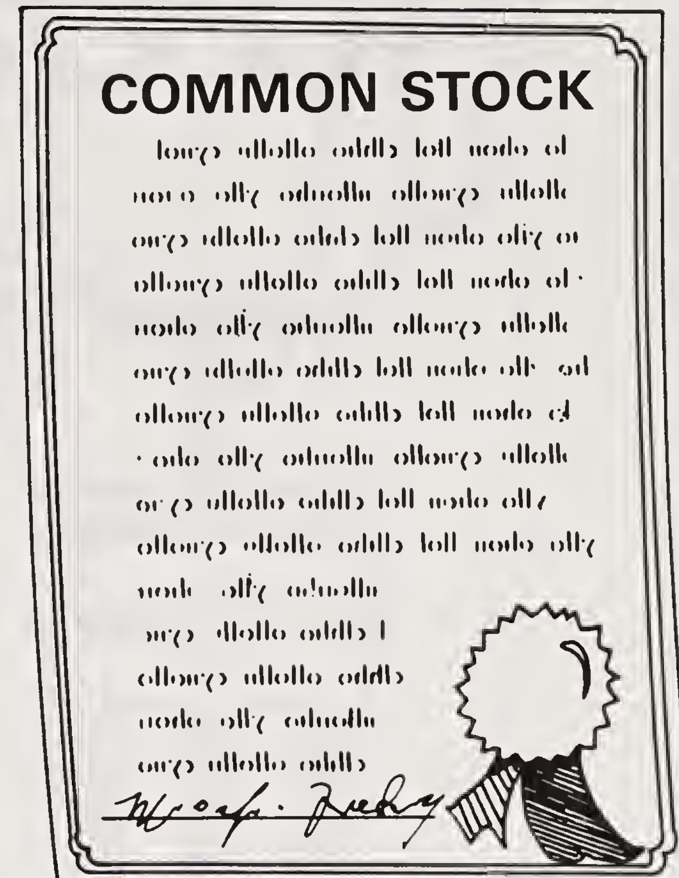
WHAT DOES A SERVICE COOPERATIVE DO?



WHAT ARE COOPERATIVES' LEGAL STATUS?

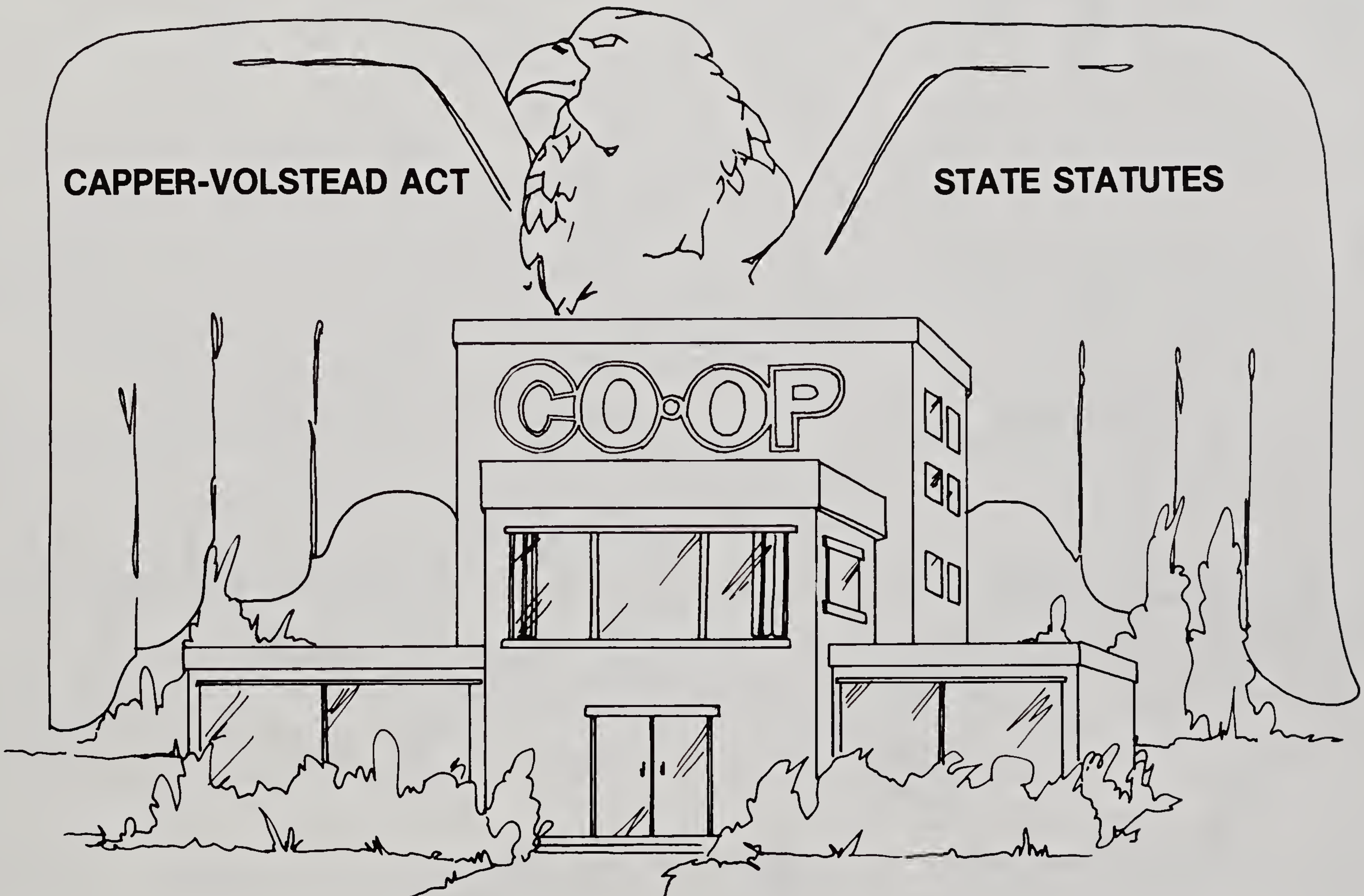


INCORPORATED OR UNINCORPORATED



STOCK OR NONSTOCK

WHAT ARE COOPERATIVES' LEGAL FOUNDATIONS?



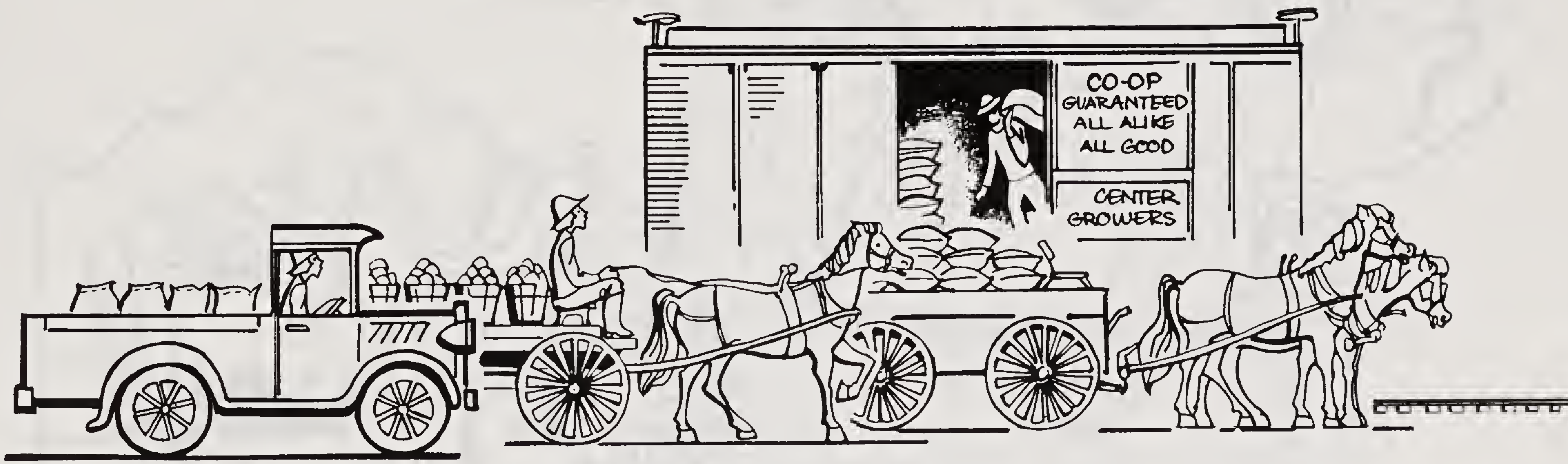
HISTORICAL COOPERATIVE DEVELOPMENTS

LESSON 2

Understanding your cooperatives

What were early forms of cooperation in this country?

- land clearing and road building
- house and barn raising
- threshing rings
- corn husking bee
- community protection

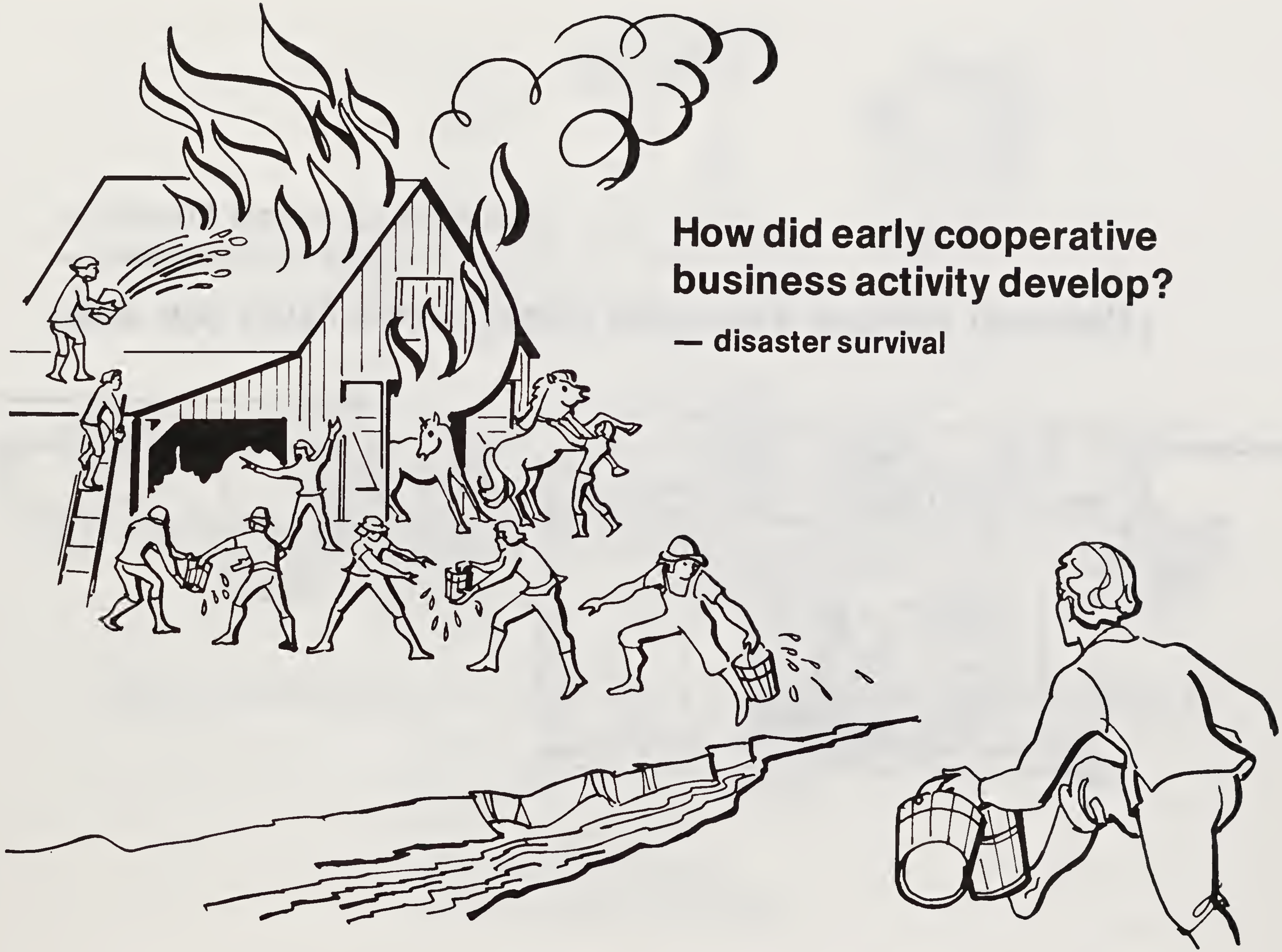


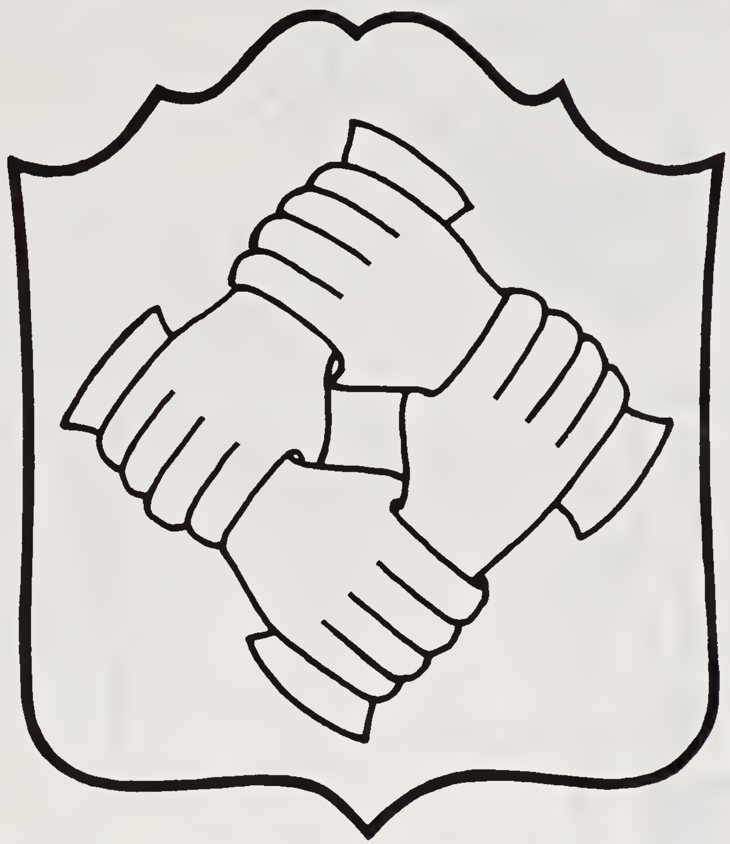
How did early cooperative business activity develop?

— marketing products
— pooling orders for supplies

How did early cooperative business activity develop?

— disaster survival





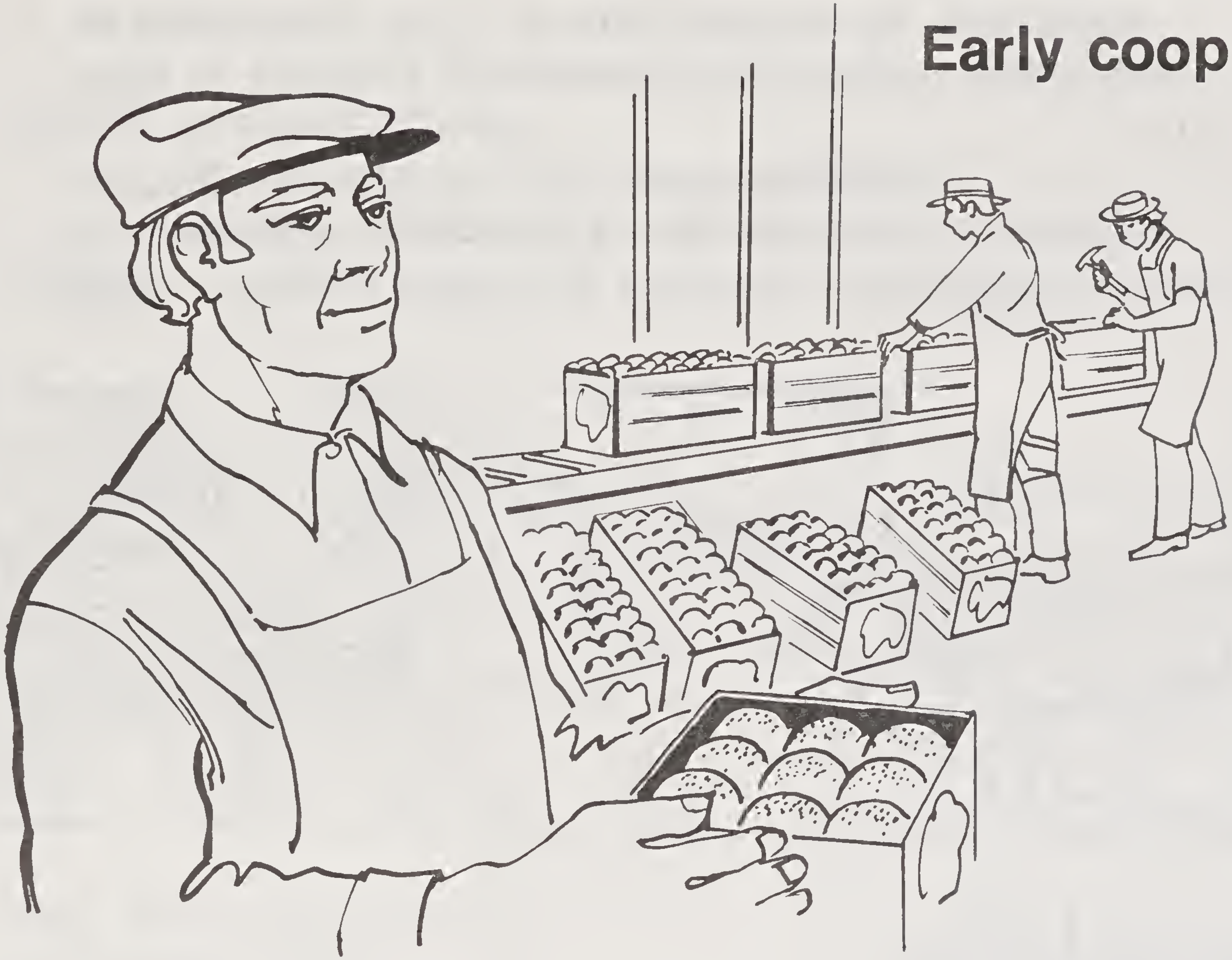
What were some of the earliest cooperative businesses?

1752 — Philadelphia Contributorship for the Insurance of Homes from Loss of Fire, Benjamin Franklin.

Early cooperative of special note:

1844 — Rochdale weavers of England

Early cooperatives:



1885 — Orange Growers Protective Union of Southern California, first citrus cooperative. Followed in 1905 by the California Fruit Growers Exchange, now known as Sunkist Growers, Inc.

Early cooperatives:

1803 — Miami Exporting Company, first formal farmer cooperative, organized by farmers and merchants to find markets for Ohio farm products.

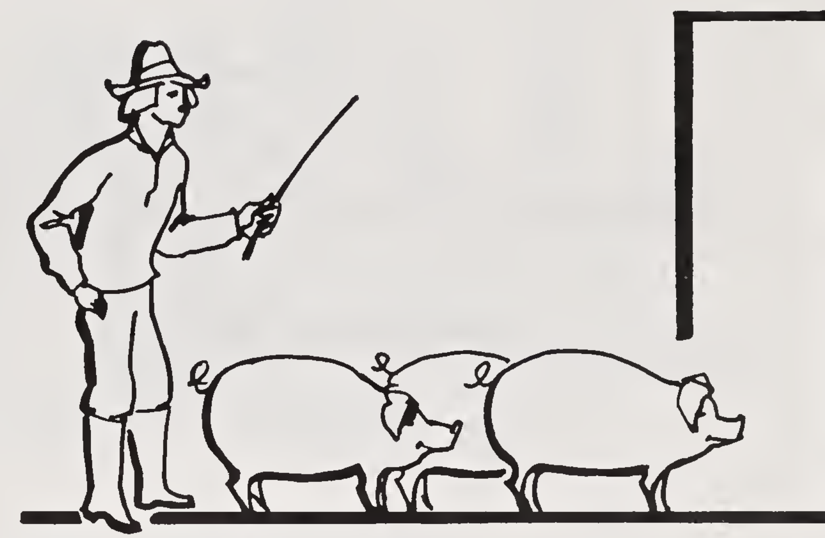
1863 — Farmers purchasing association organized at Riverhead, N.Y., to buy fertilizer for members.

Early cooperatives:

1810

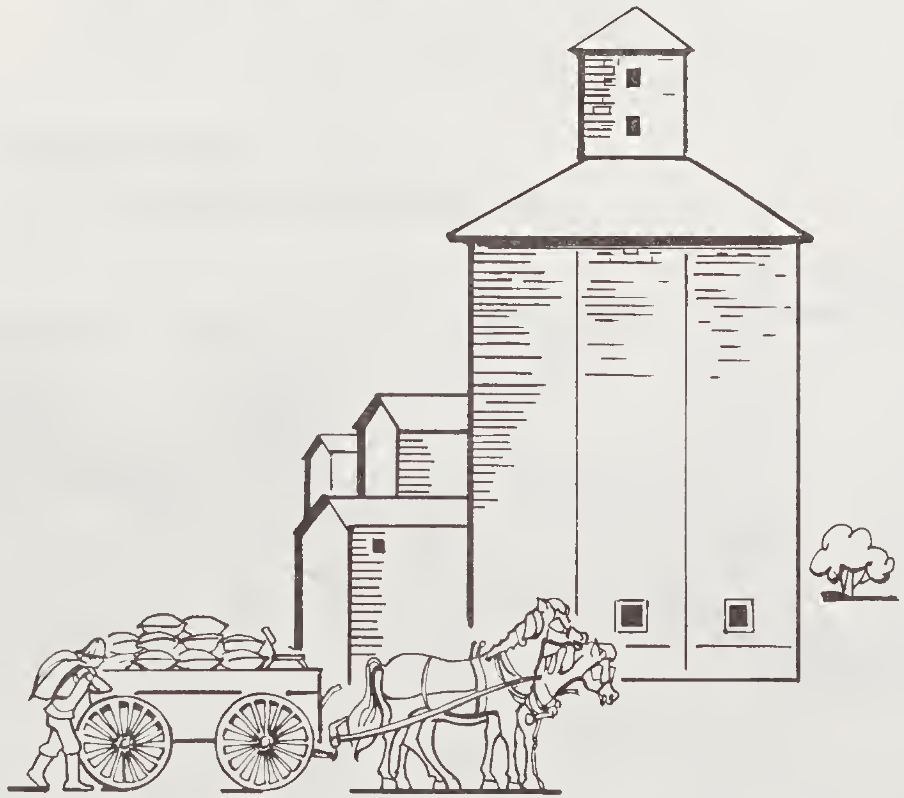
First dairy cooperative
at Goshen, Conn.

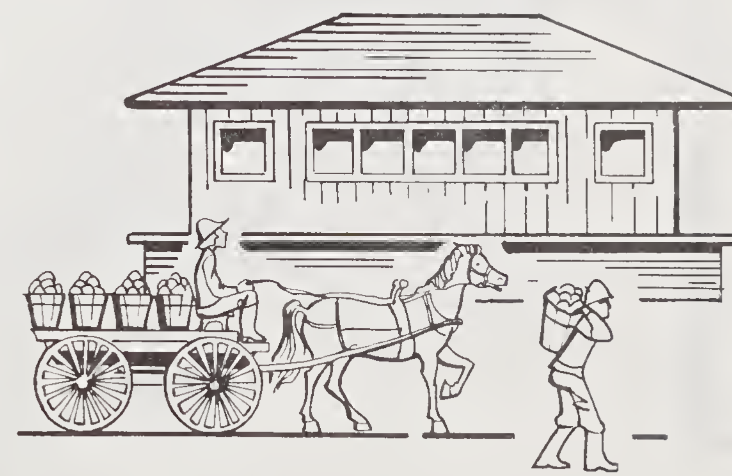
1820



Licking Exporting Company,
Granville, Ohio, first hog
marketing, slaughter, and
packing cooperative.

Early cooperatives:





1857 — Grain elevator was organized at Madison, Wis.

1867 — Fruit Growers Union and Cooperative Society, Hammonton, N.J., first fruit marketing cooperative.

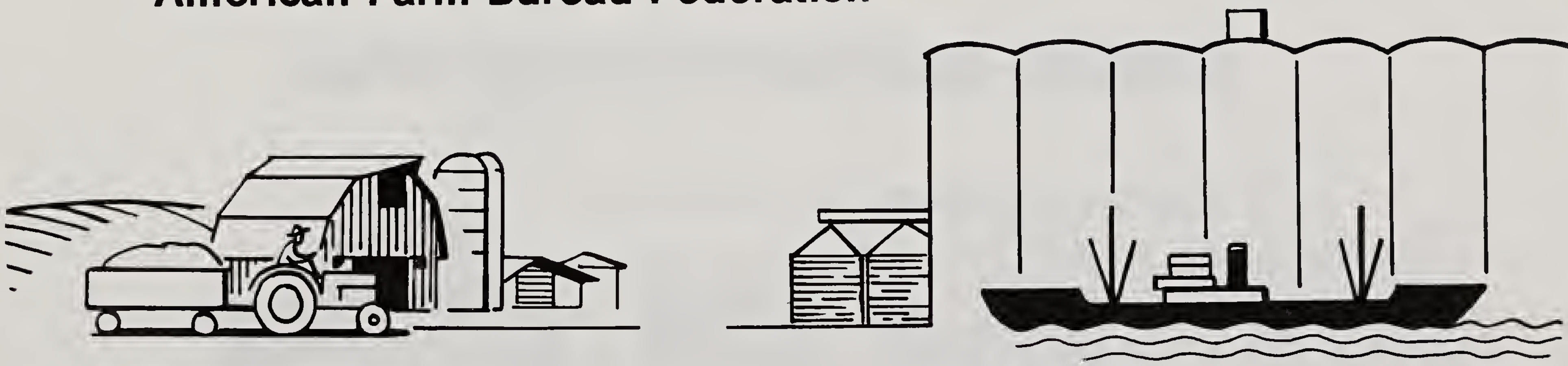
1874 — Illinois State Grange made earliest recorded effort to establish a cooperative to market poultry and other farm products.

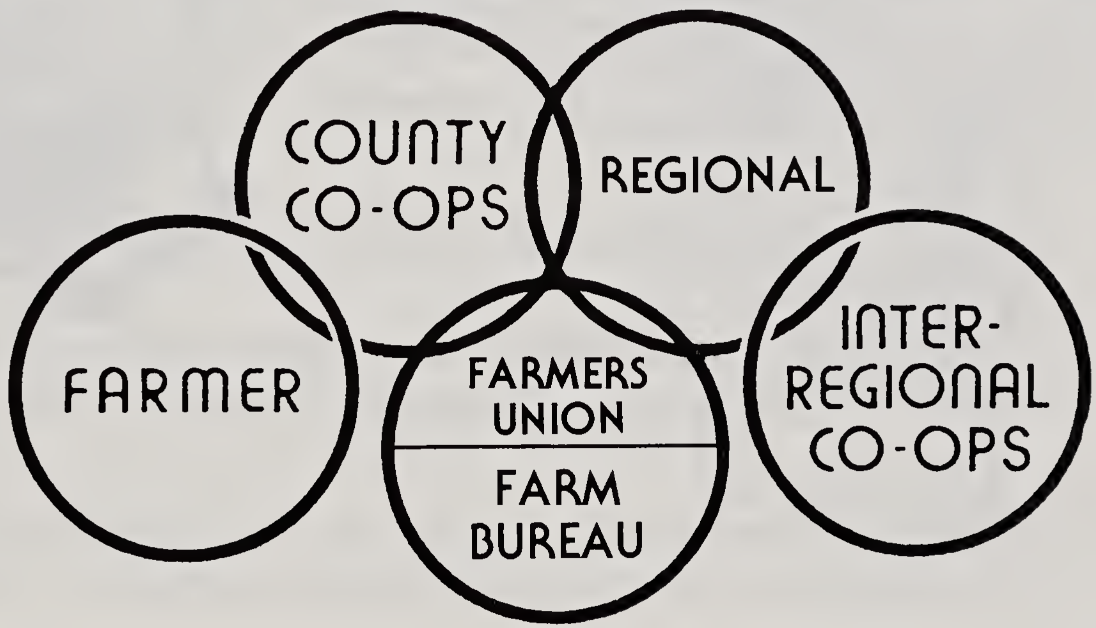
Where did early leadership develop?

National Grange (The Order of Patrons of Husbandry)
American Society of Equity

Early leadership:

National Farmers Union
American Farm Bureau Federation





What differing schools of thought developed?

Aaron Sapiro

The Legal Monopoly

Schools of thought:

E.G. Nourse:

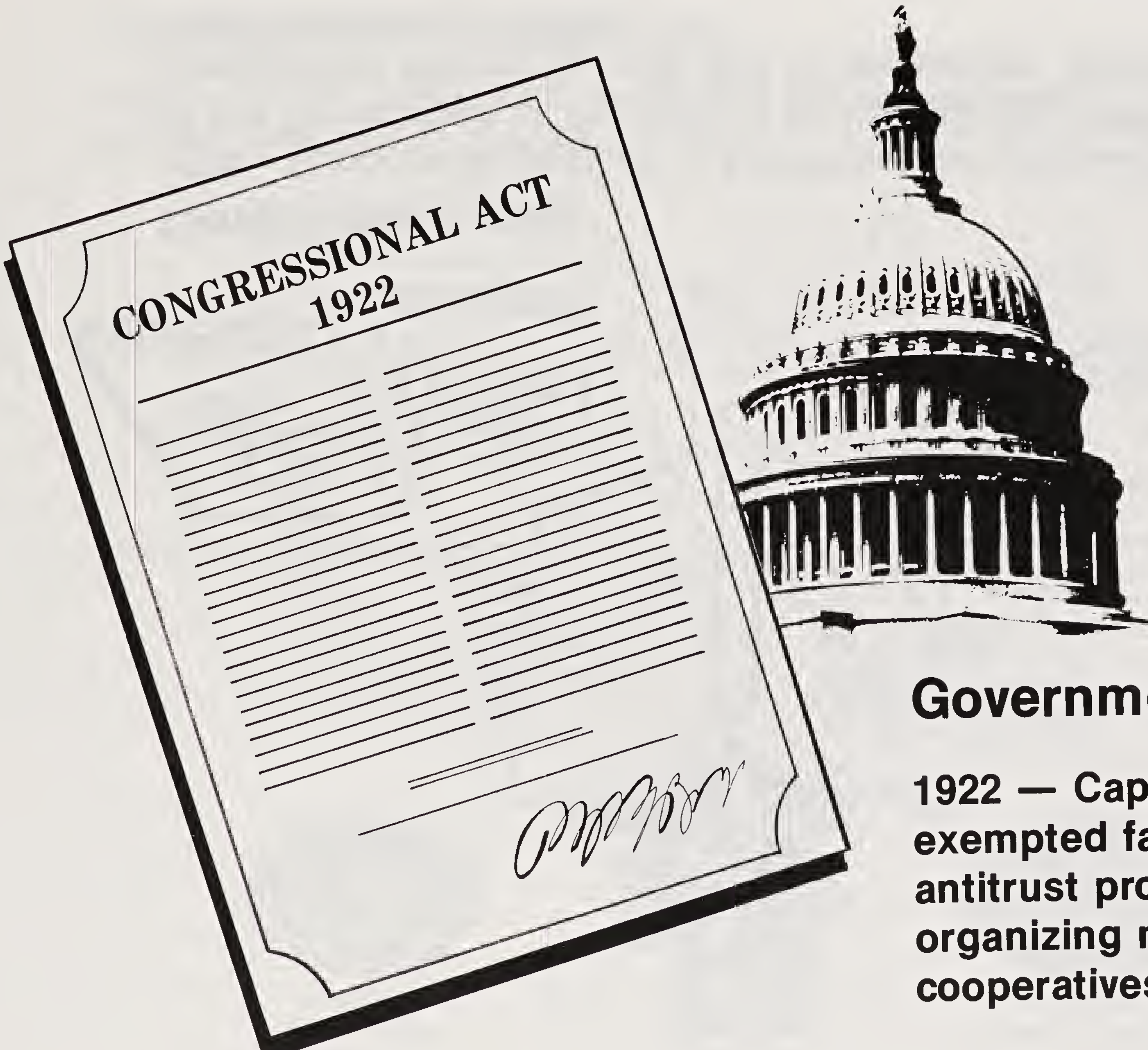
"The competitive yardstick"

What has been the role of State Government in farmer cooperative development?

1865 — Michigan passed first law recognizing the cooperative method for buying and selling.

Government role:

1914 — The Smith Lever Act created the Extension Service in the Department of Agriculture and increased educational emphasis on cooperatives.



Government role:

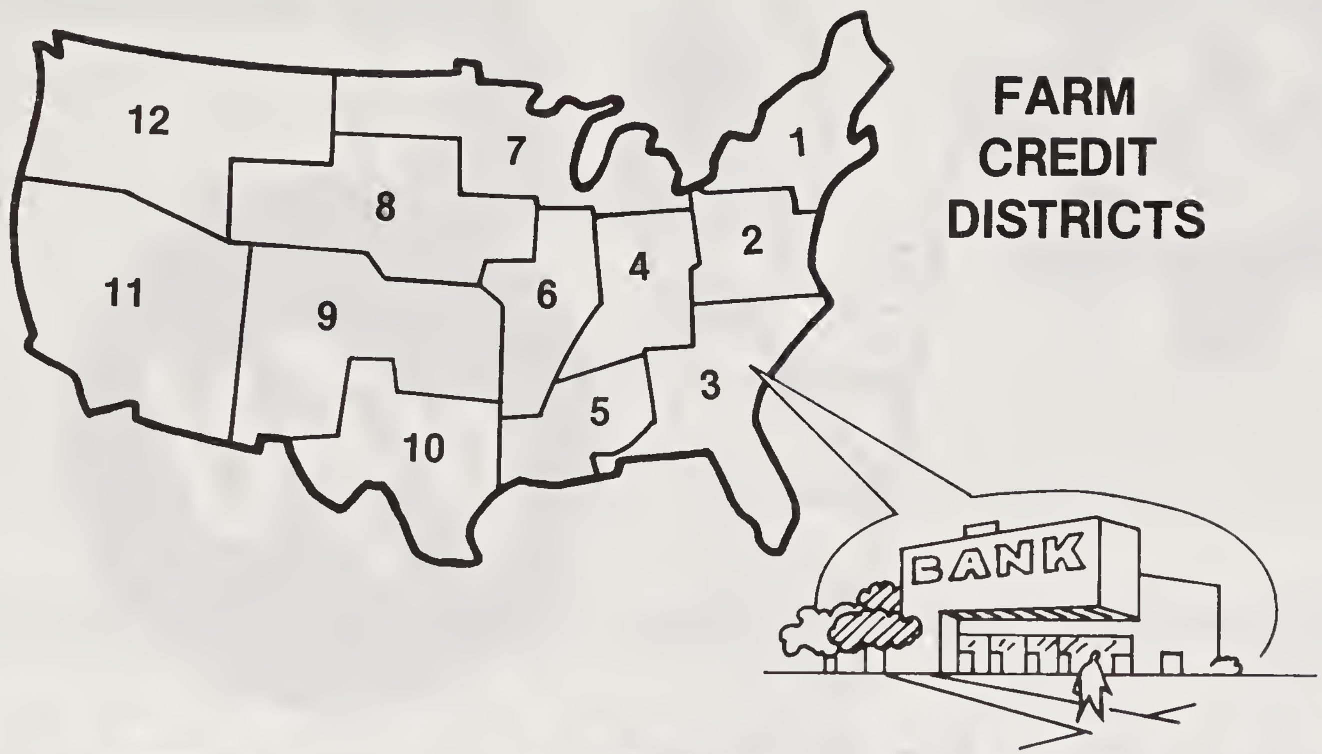
1922 — Capper-Volstead Act exempted farmers from antitrust prosecution for organizing marketing cooperatives.

Government role:

1926 - Cooperative Marketing Act formalized cooperative assistance in the Department of Agriculture by establishing a Division of Cooperative Marketing, now part of Economics, Statistics, and Cooperatives Service.

Federal Government role:

1933 — Farm Credit Act resulted in the development of the Farm Credit System.



FARM CREDIT DISTRICTS

Federal LAND BANK Association

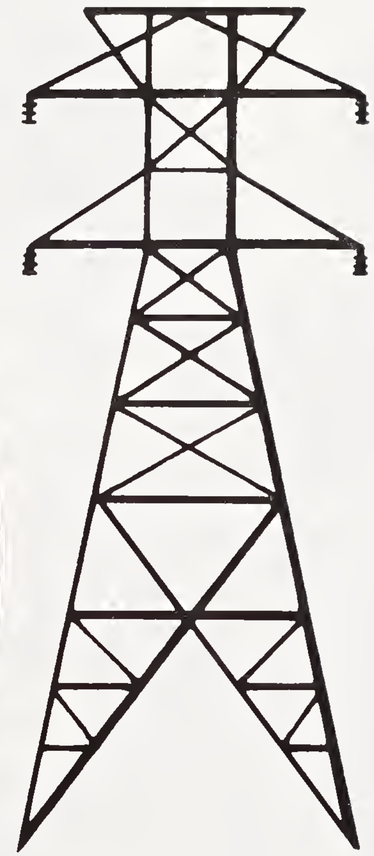
Long term
Farm Credit
1916

Production Credit Association

Short and Intermediate term
Farm Credit
1923

Bank for Cooperatives

Financing for
Farmer Cooperatives
1933



Government role:

1935 — Rural Electrification Act provided financial assistance to rural electric and telephone cooperatives.

What national organizations serve farmer cooperatives?

American Institute of Cooperation — information and educational assistance.

Cooperative League of the USA — educational and consumer assistance.

National Council of Farmer Cooperatives — legislative assistance.

nmpf

RE

CU

acdi

National organizations:

National Milk Producers Federation — legislative assistance

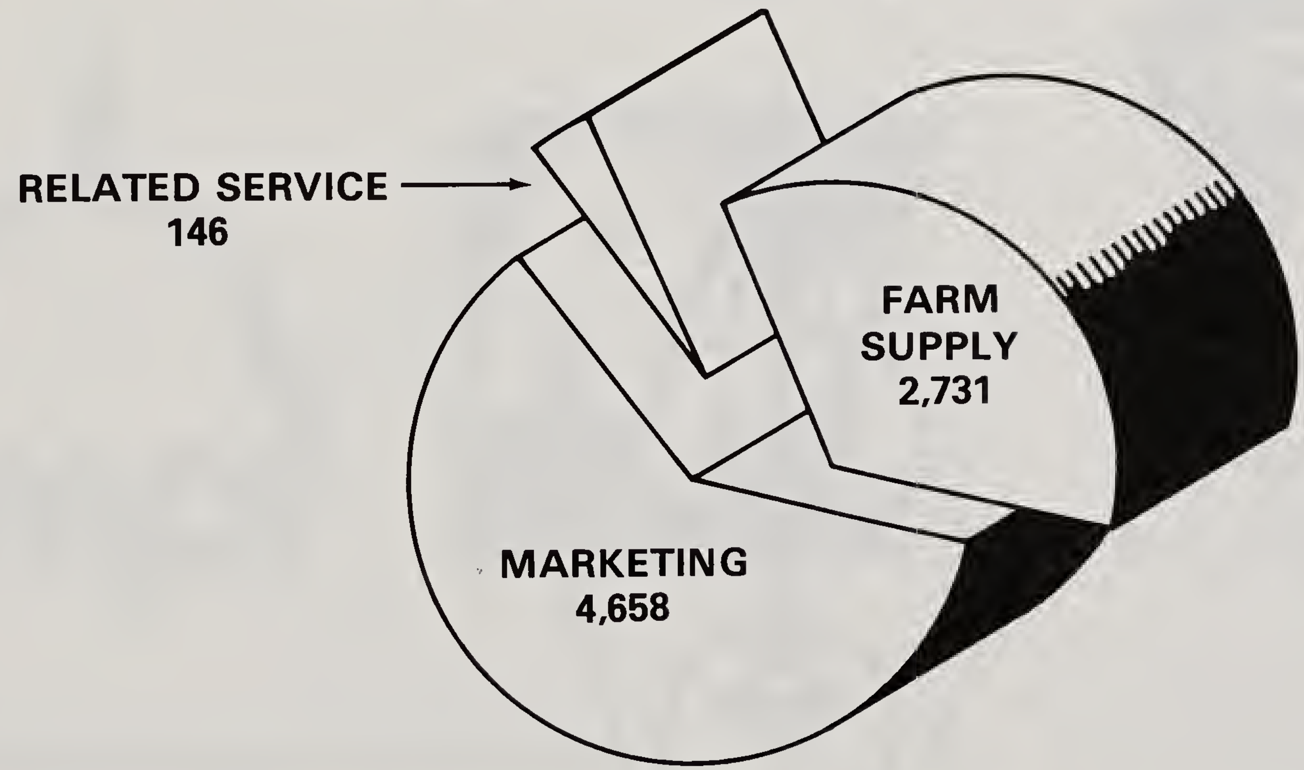
National Rural Electric Cooperative Association — legislative assistance

Credit Union National Association

Agricultural Cooperative Development International

State Cooperative Organizations

NUMBER OF COOPERATIVES
1976



What is the extent of present farmer cooperative activity in the U.S.?

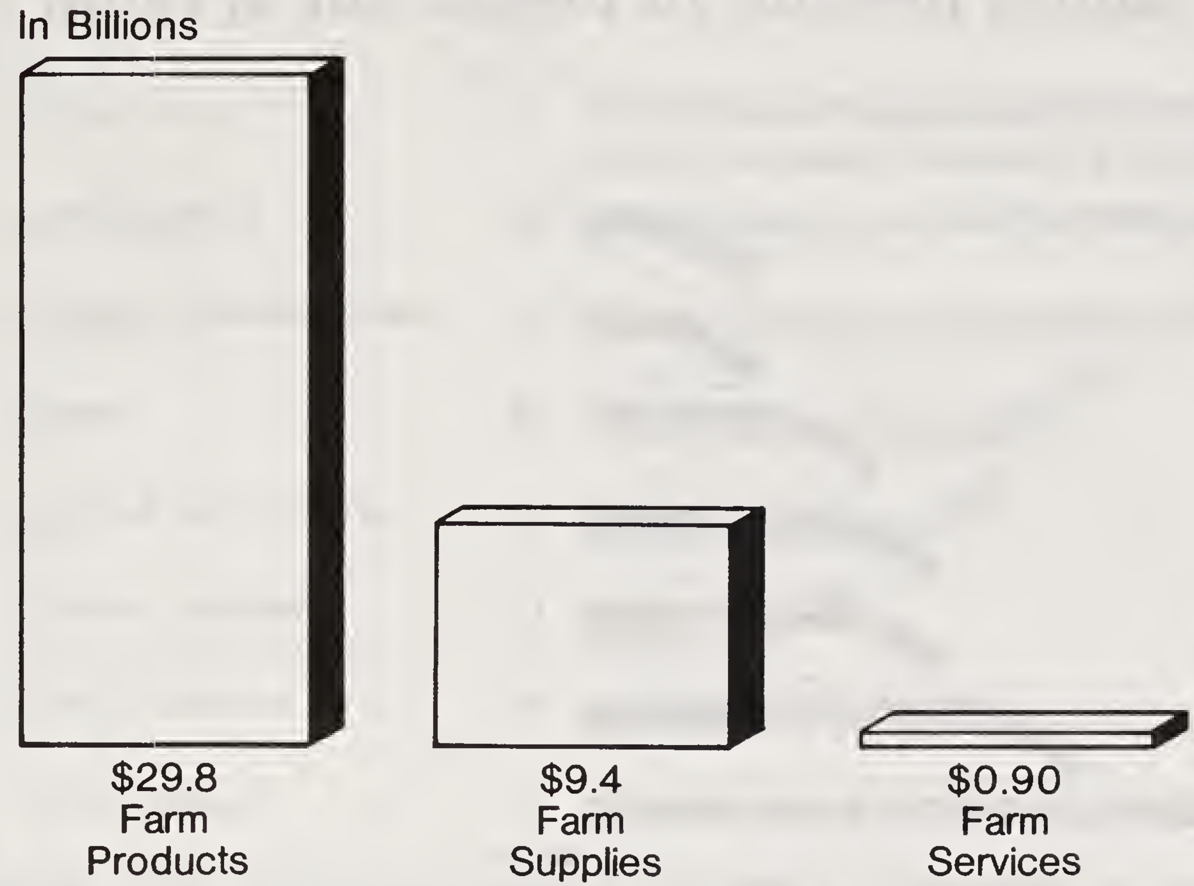
—5 out of 6 farmers are members of at least one cooperative

—cooperative memberships total 5.9 million

—7,535 different cooperatives are in operation

COOPERATIVE BUSINESS VOLUME
1976

NET BUSINESS
Excludes intercooperative business

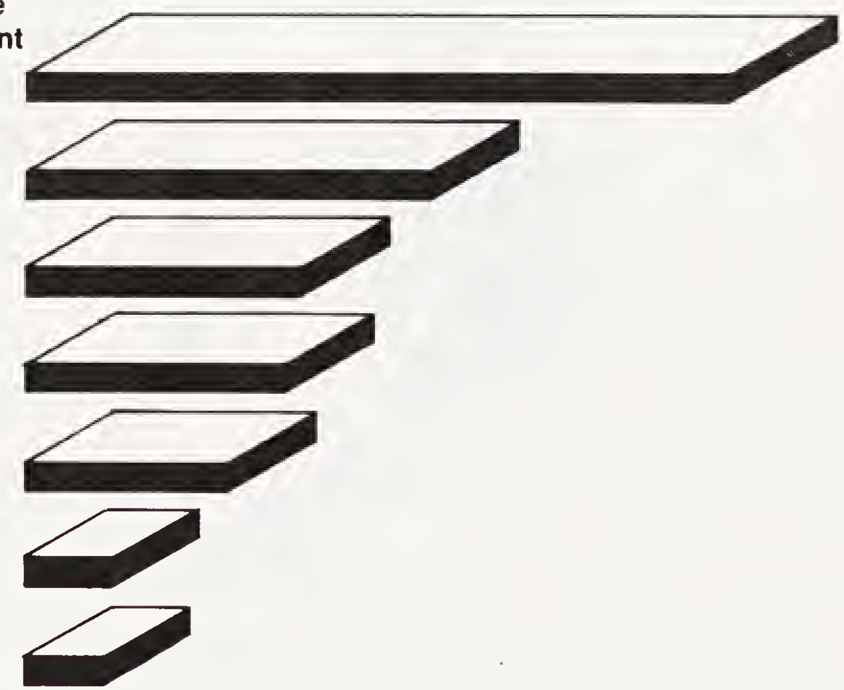


What is the extent of farmer cooperative business activity in the U.S.?

—combined annual net volume exceeds $40 billion.

COOPERATIVES' COMBINED MARKET SHARE AT THE FARM LEVEL 1976

Number of Cooperatives Handling		Market Share Percent
579	Dairy products	74
2,599	Grain & soybeans	40
436	Fruits & vegetables	27
519	Cotton & cotton products	26
214	Other	20
654	Livestock & livestock products	9
151	Poultry products	8



Based on net marketing business of $25.8 billion

What is the extent of present farmer cooperative activity in the United States?

—farmers market 29 percent of their products through their own cooperatives

COOPERATIVES' COMBINED MARKET SHARE AT THE FARM LEVEL 1976

Number of Cooperatives Handling		Market Share Percent
3,949	Fertilizer & lime	36
3,597	Farm chemicals	33
2,983	Petroleum	28
3,819	Feed	19
3,526	Seed	15
4,432	Other supplies & equipment	8

Based on net farm supply business of $8.7 billion

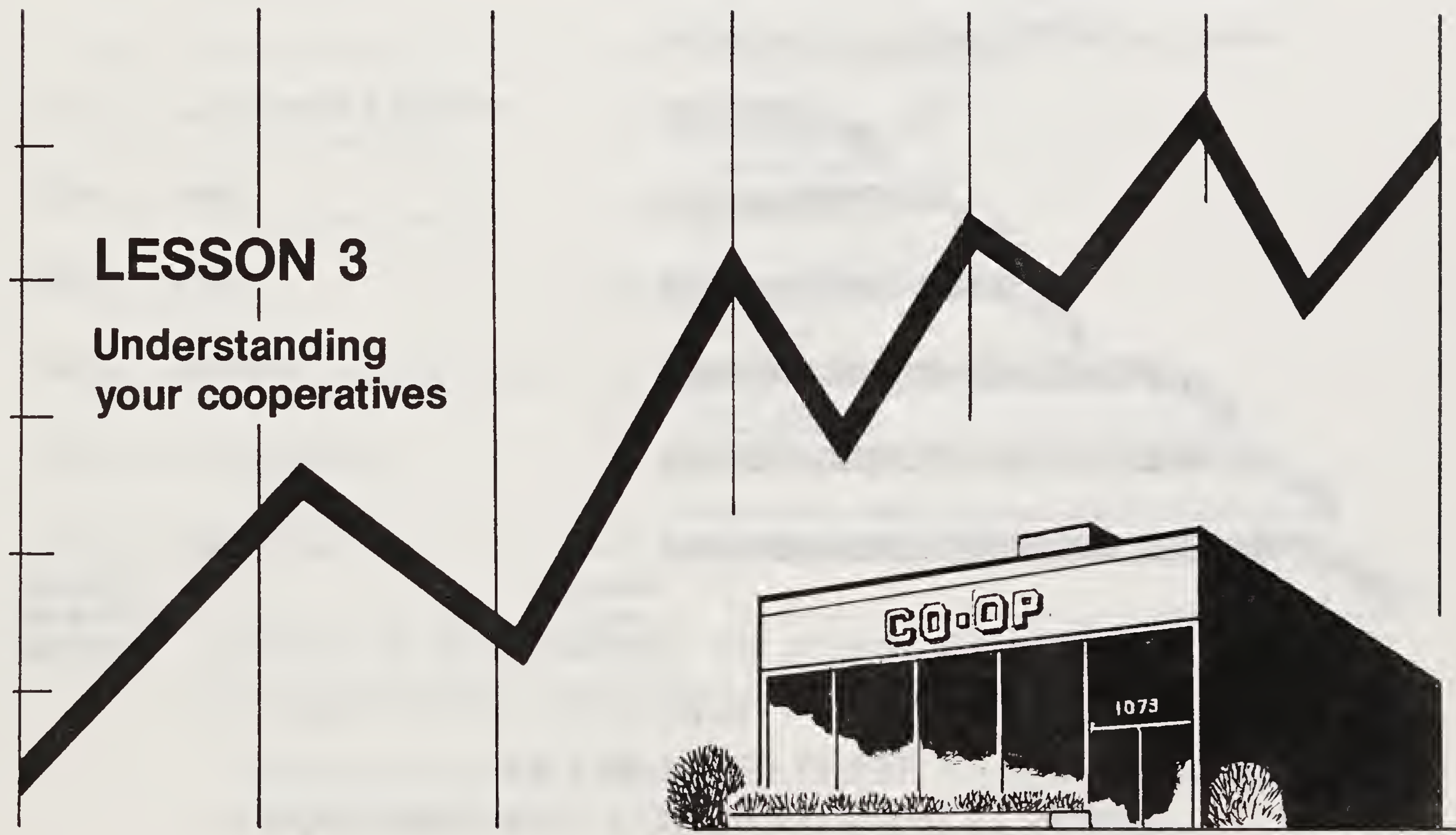
What is the extent of present farmer cooperative activity in the United States?

—farmers purchase 18 percent of their production supplies through their own cooperatives

ECONOMIC DEMOCRACY IN ACTION

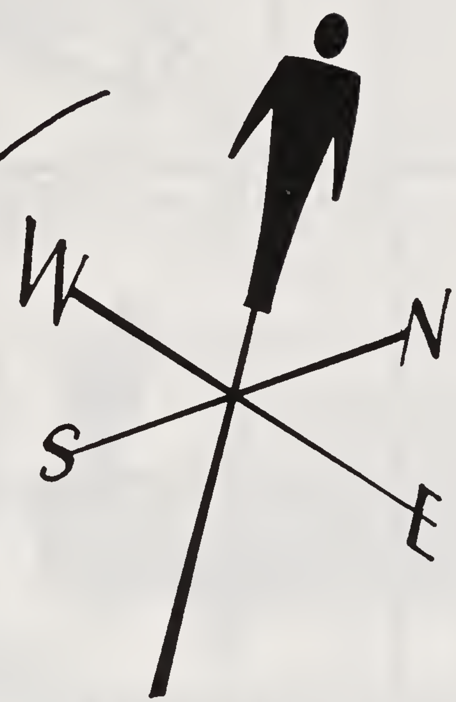
LESSON 3

Understanding your cooperatives

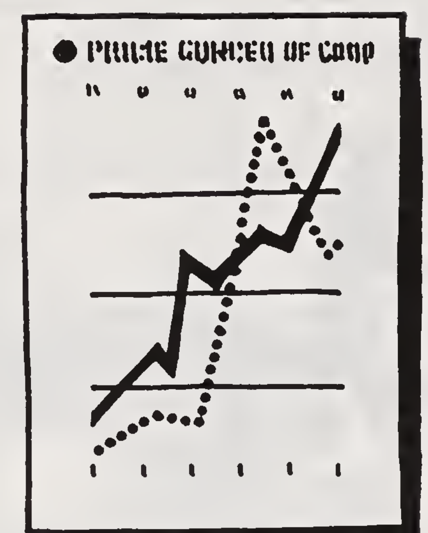


HOW DO YOU ORGANIZE A COOPERATIVE?

INTERESTED LEADERS MEET



MEMBERSHIP POTENTIAL DETERMINED



ECONOMIC FEASIBILITY STUDY CONDUCTED

NECESSARY LEGAL PAPERS FILED

WHO ARE THE KEY PEOPLE IN A COOPERATIVE?

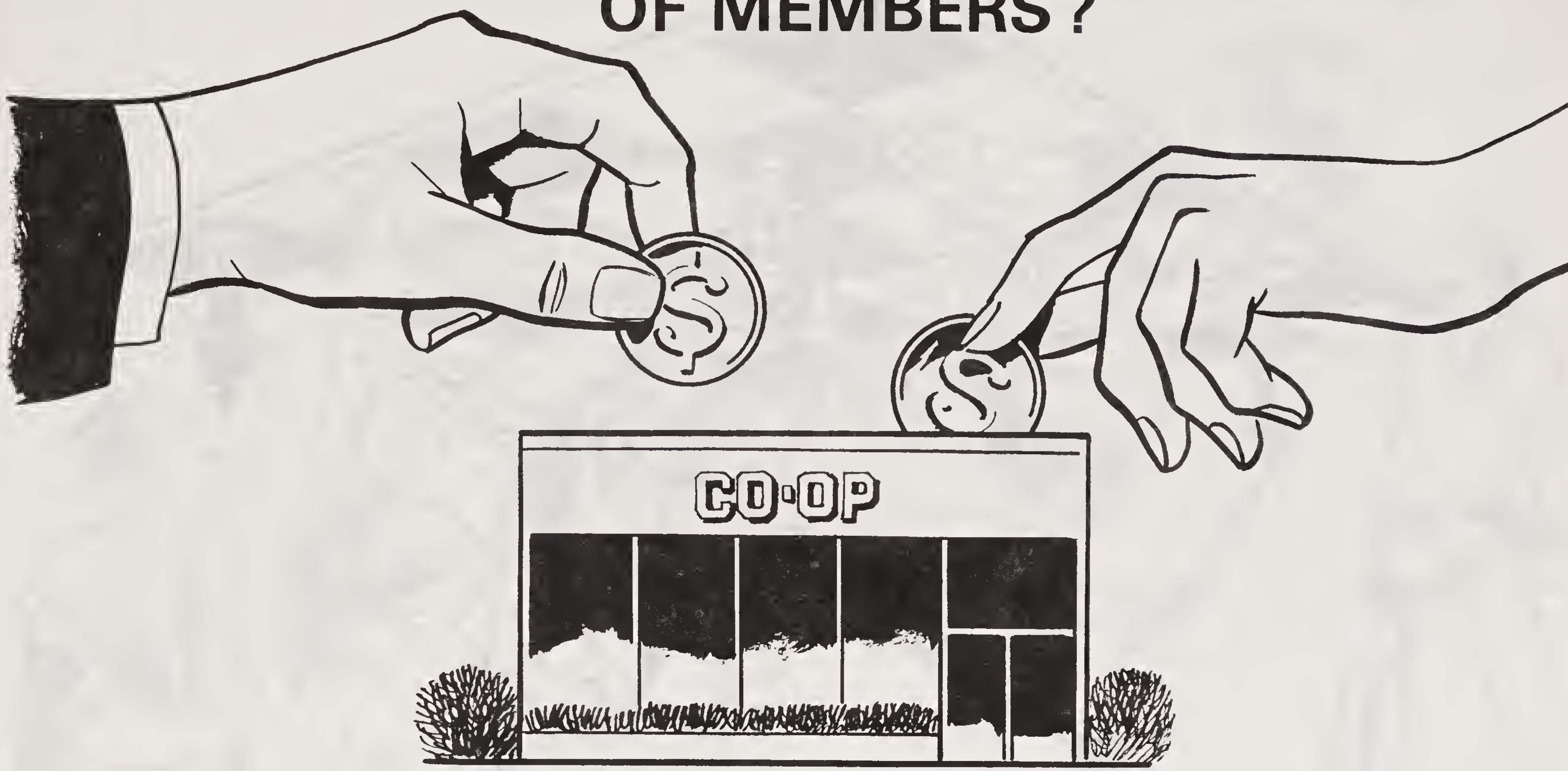
MEMBERS

BOARD OF DIRECTORS

MANAGER

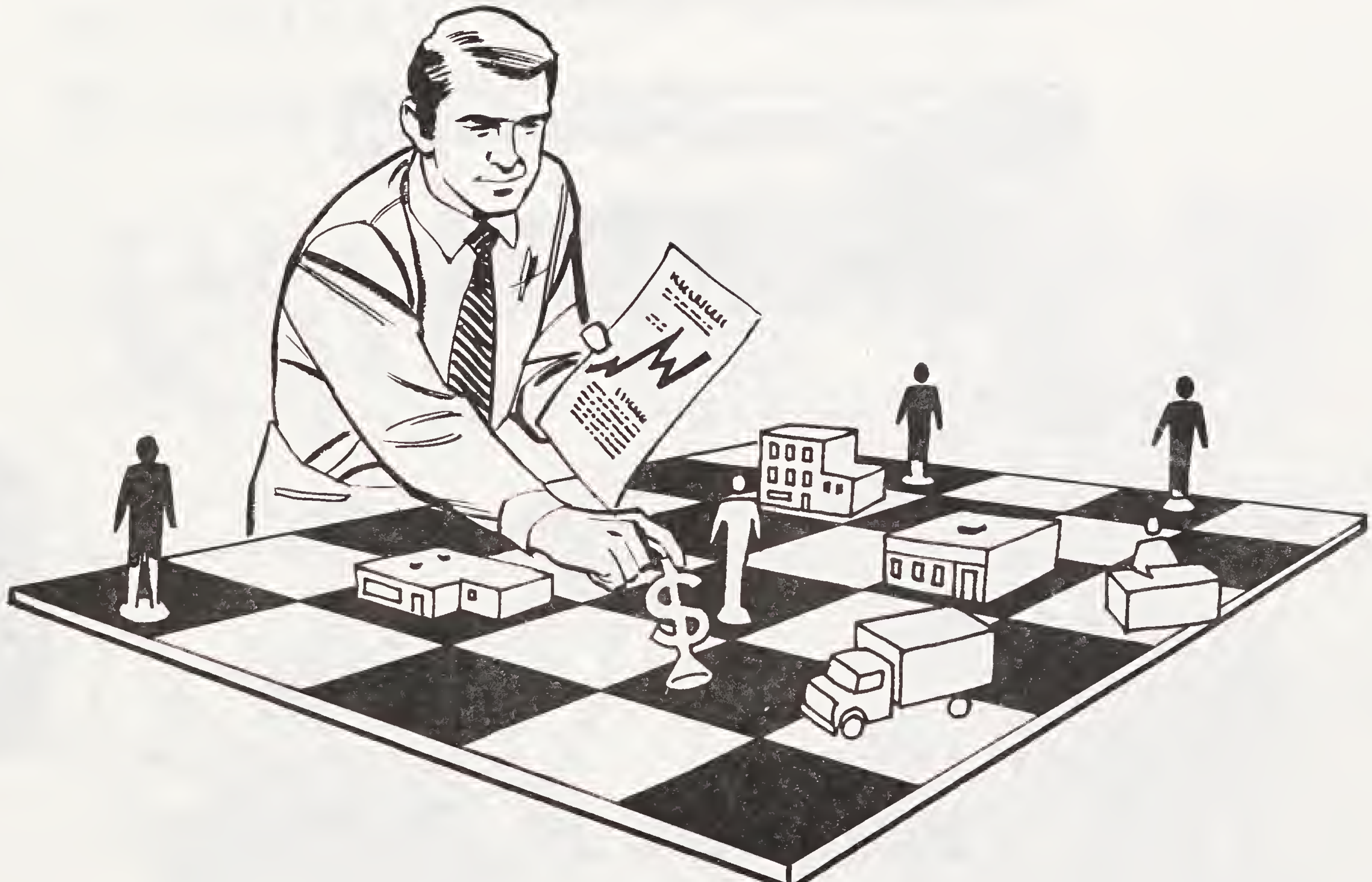
EMPLOYEE WORK FORCE

WHAT ARE THE RESPONSIBILITIES OF MEMBERS?



. . . Provide Financing

MEMBER RESPONSIBILITY



. . . Provide Management

MEMBER RESPONSIBILITY
. . . Participate in Decision Making

3-5

MEMBER RESPONSIBILITY

. . . give maximum patronage support

MEMBER RESPONSIBILITY
. . . Establish Community Involvement

WHAT ARE RESPONSIBILITIES OF DIRECTORS?

. . . Represent Members

DIRECTOR RESPONSIBILITY

. . . Formulate Policy

DIRECTOR RESPONSIBILITY

. . . Hire Managerial Personnel

DIRECTOR RESPONSIBILITY
. . . Evaluate Cooperative Performance

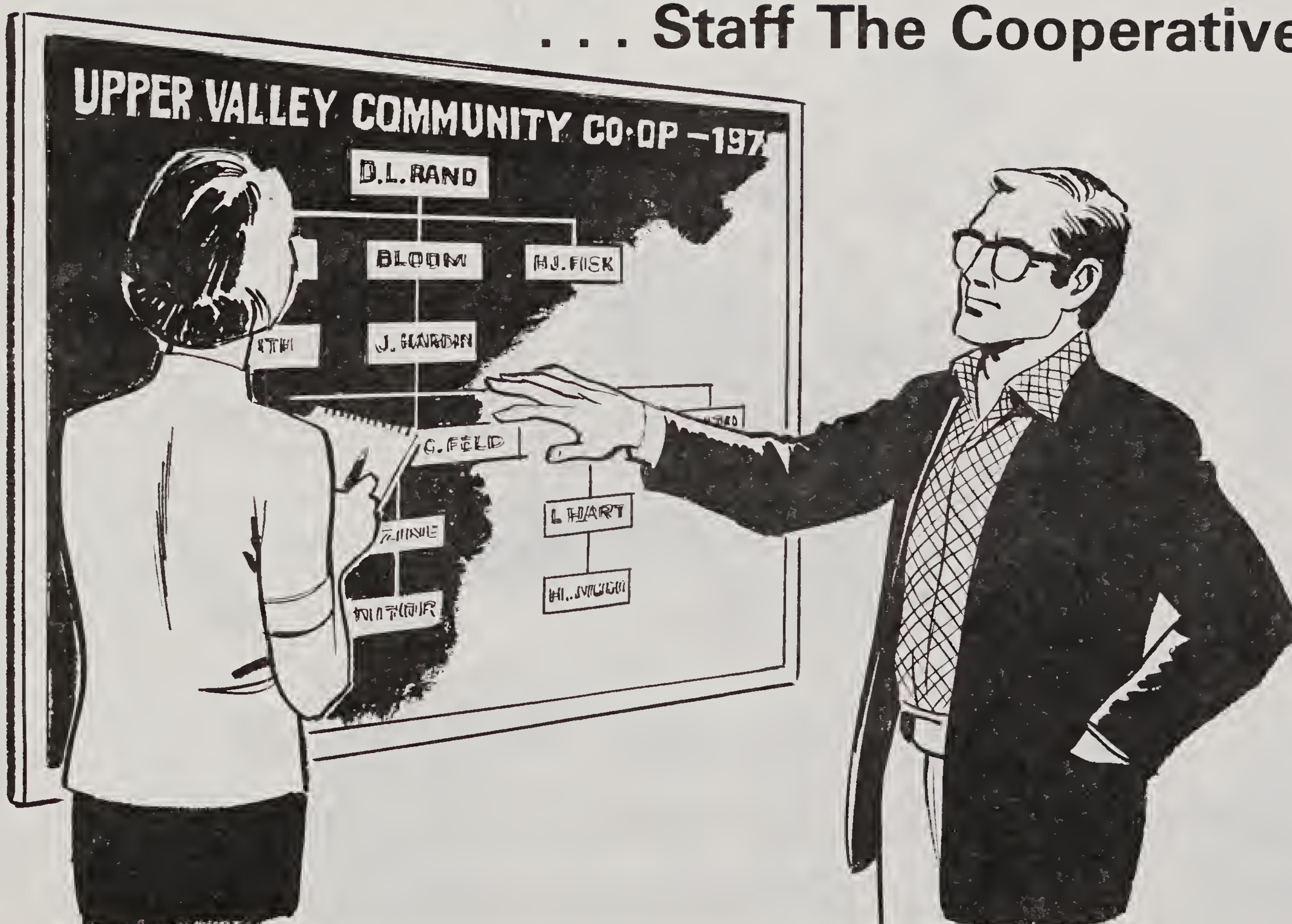
DIRECTOR RESPONSIBILITY
. . . Report To Member-Owners

DIRECTOR RESPONSIBILITY

. . . Assume Liability For Cooperative's Operations And Actions

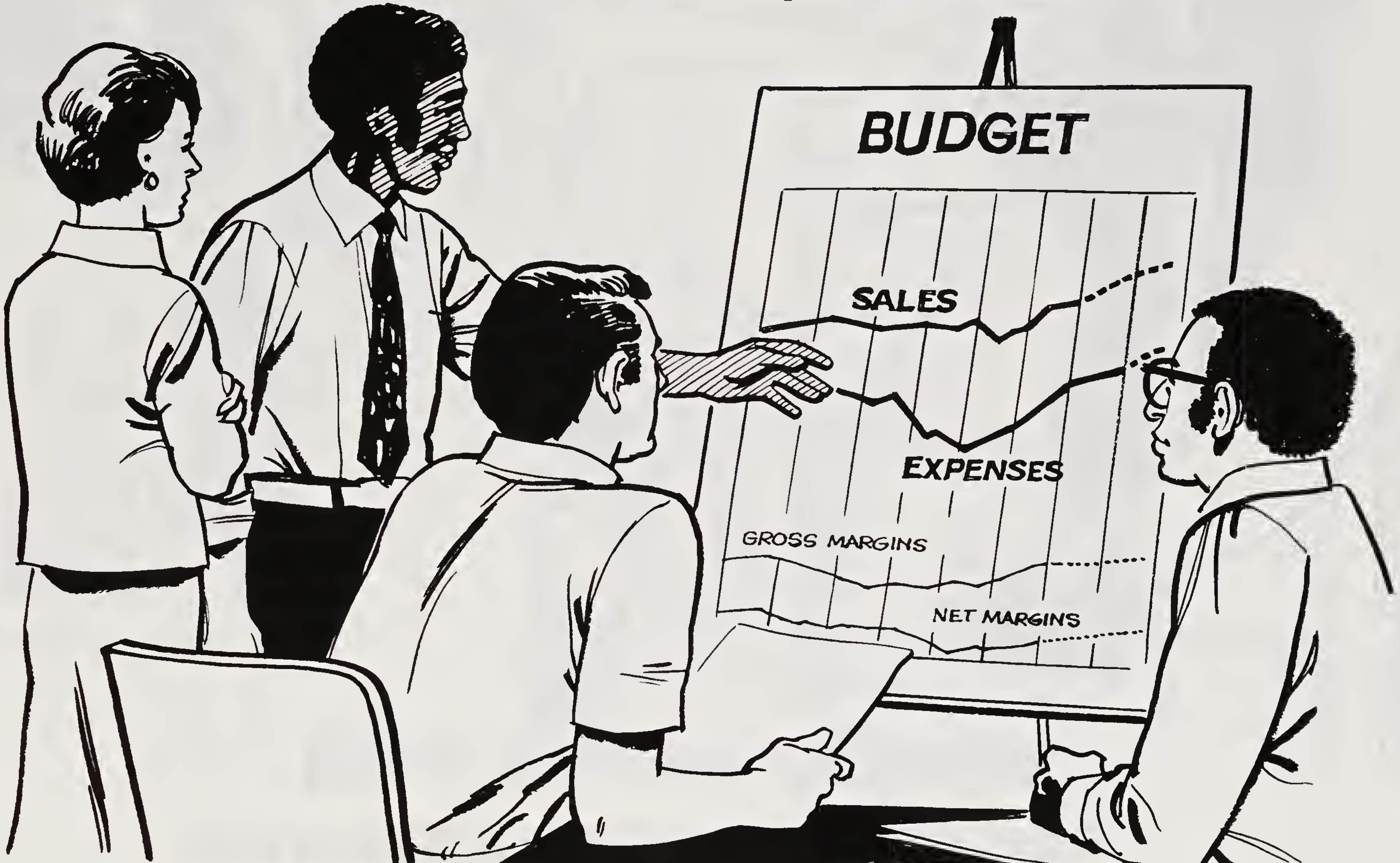
WHAT ARE THE MANAGER'S RESPONSIBILITIES?

. . . Staff The Cooperative



MANAGER RESPONSIBILITY

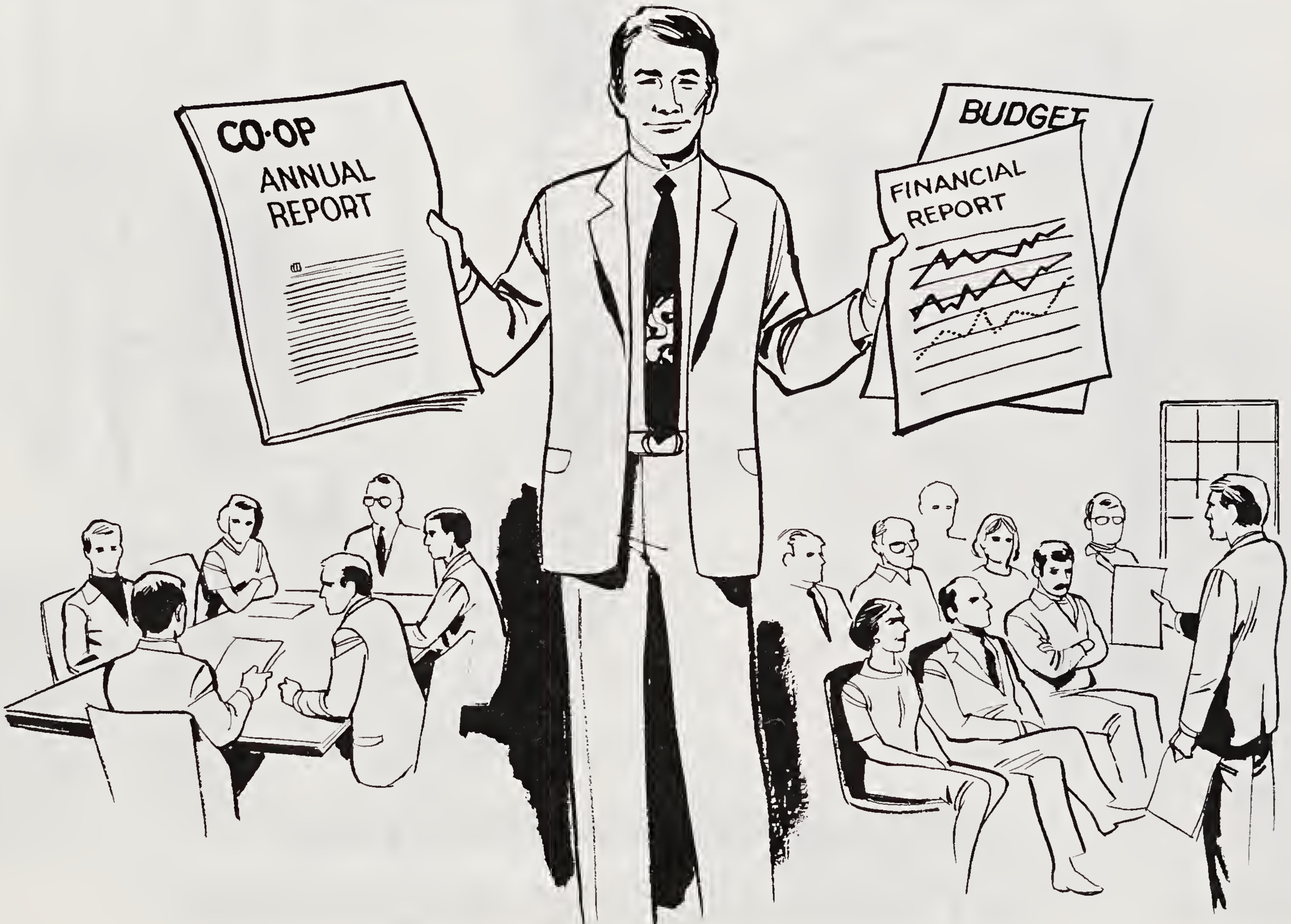
. . . Develop Goals and Plans to Reach Objectives Set by the Board



MANAGER RESPONSIBILITIES
. . . Direct Business Activities

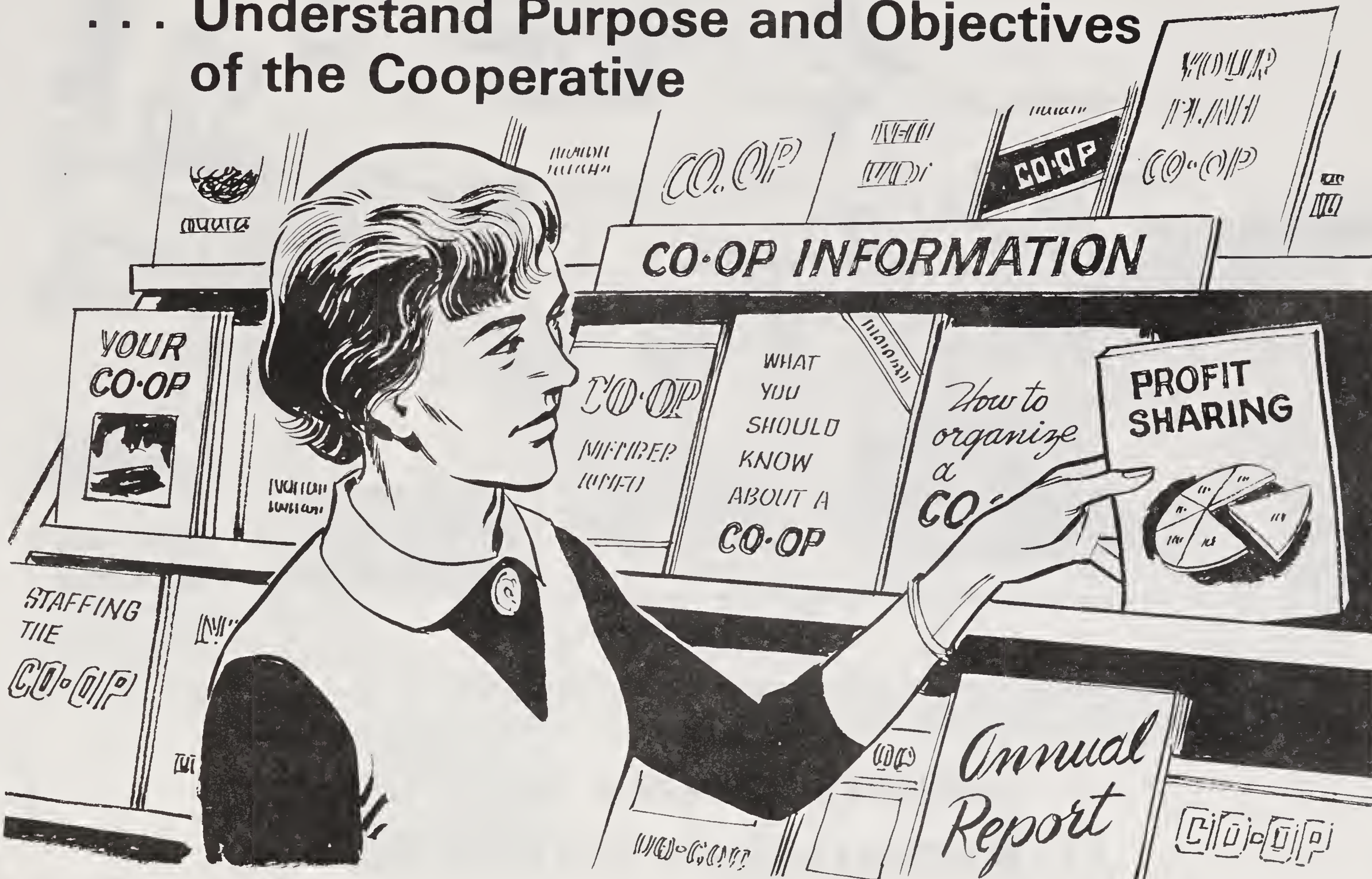
MANAGER RESPONSIBILITY
. . . Performance Evaluation

MANAGER RESPONSIBILITY
. . . Report to Board and Membership

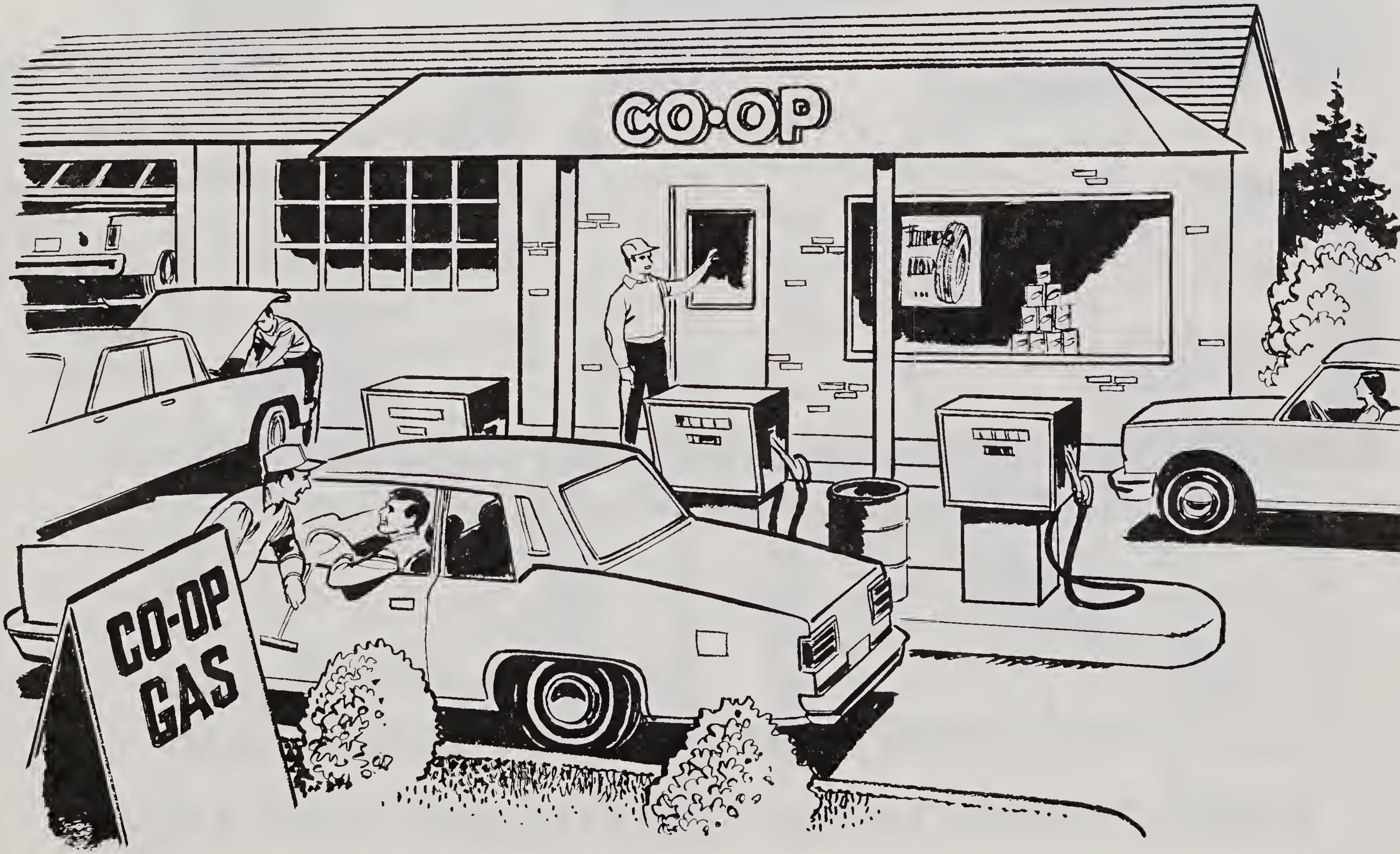


WHAT ARE EMPLOYEES RESPONSIBILITIES?

. . . Understand Purpose and Objectives of the Cooperative



EMPLOYEE RESPONSIBILITY
. . . Fully Perform Duties



EMPLOYEE RESPONSIBILITY
. . . Understand Relationship to Member-Owner Patrons

EMPLOYEE RESPONSIBILITY

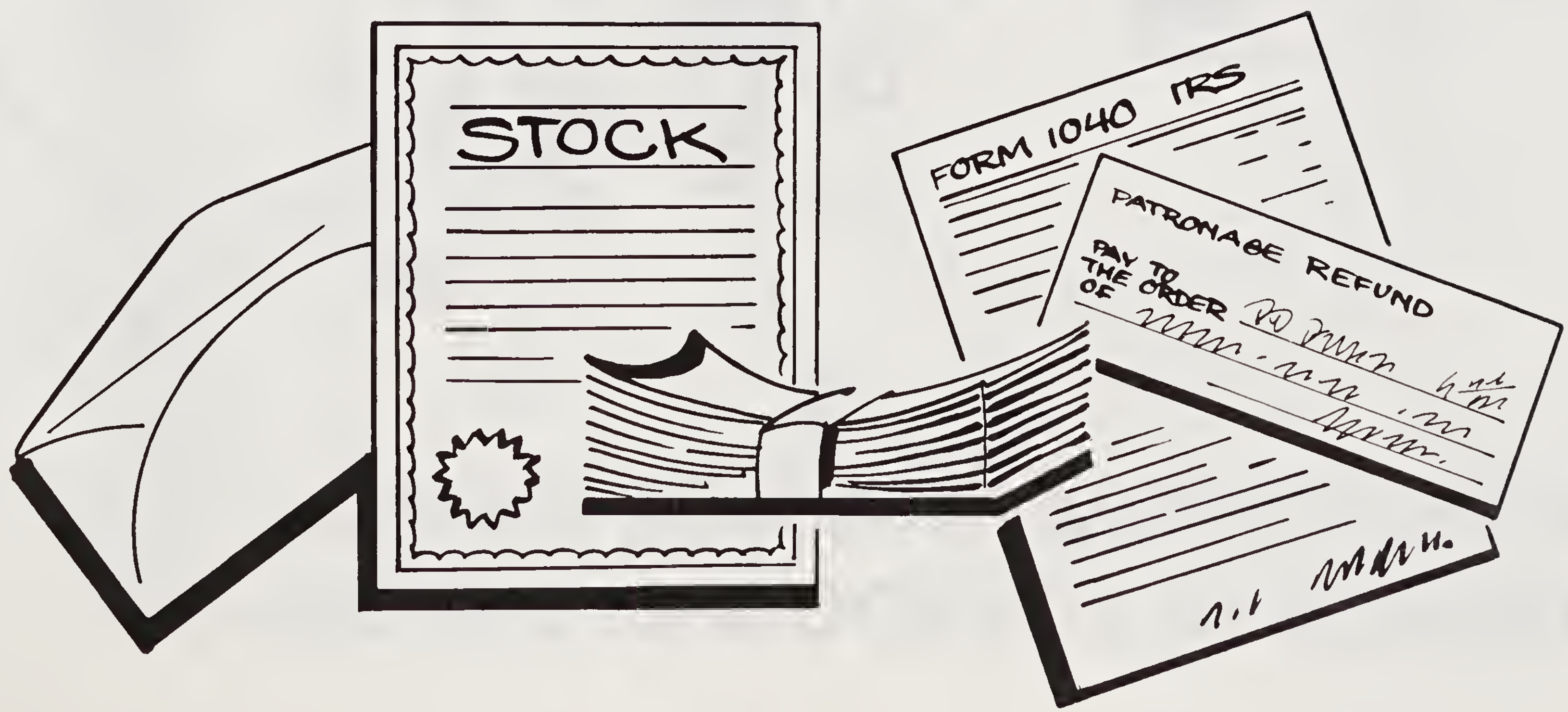
. . . Favorably Represent the Cooperative

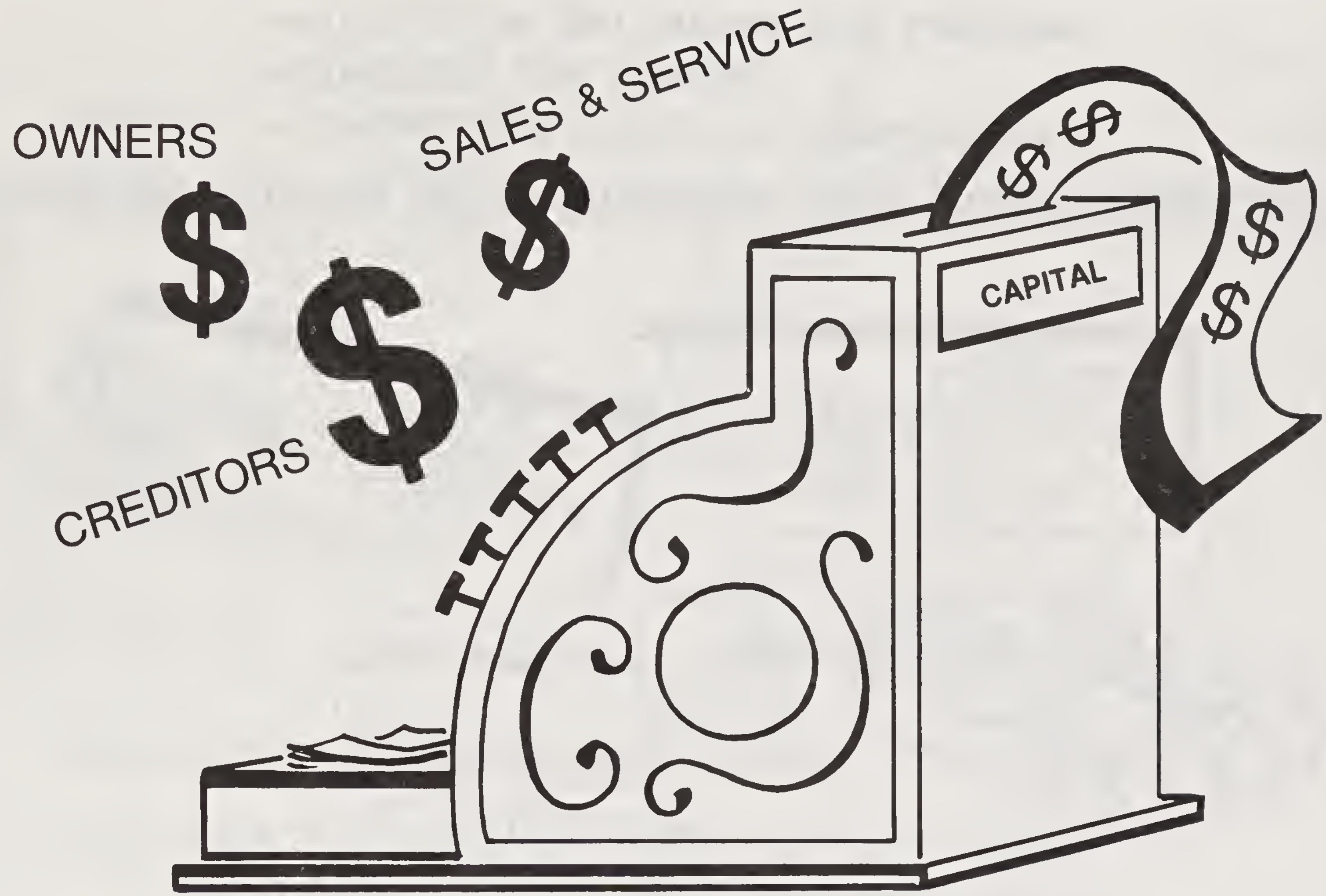
ECONOMIC DEMOCRACY IN ACTION
. . . Requires Everybody Working Together

PRINCIPLES UNDERLYING COOPERATIVE FINANCING AND TAXATION

LESSON 4

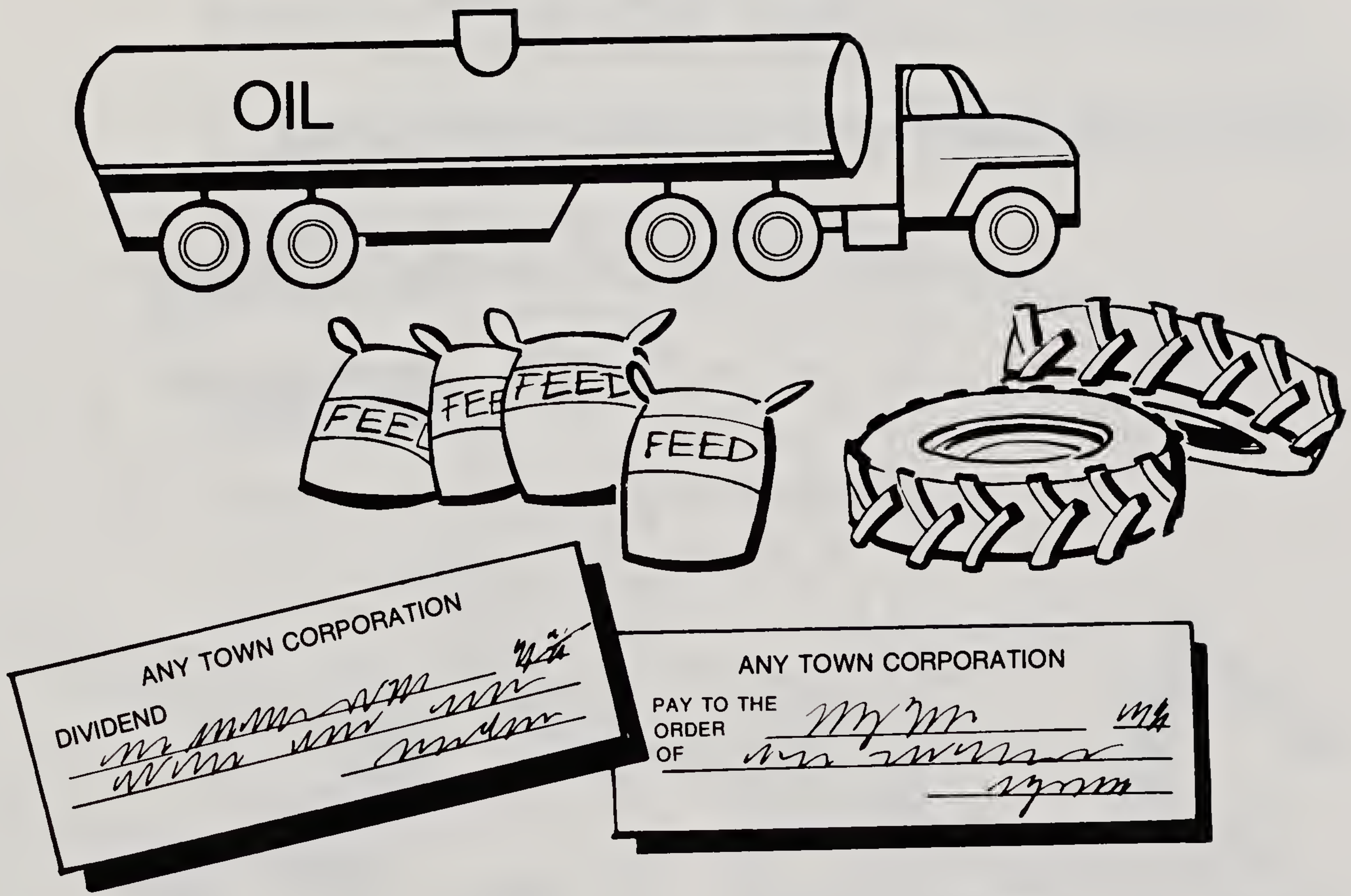
Understanding your cooperatives





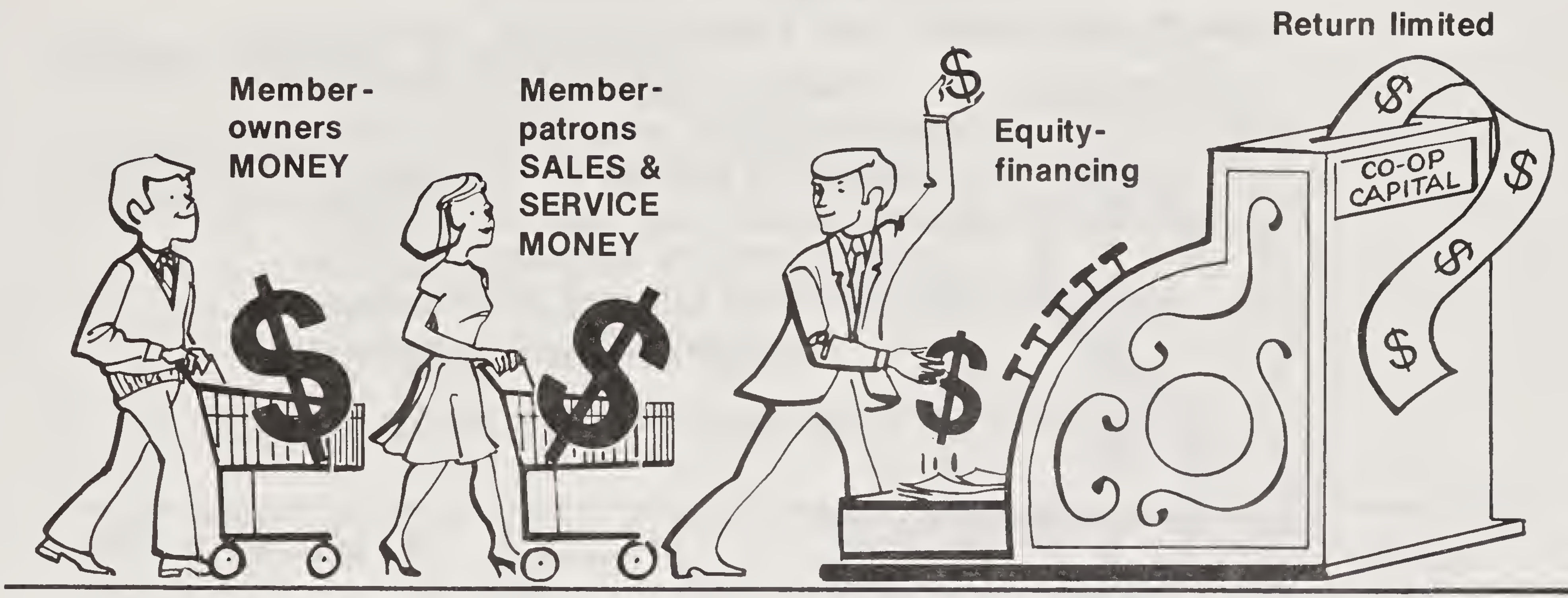
Who finances a business?

—owners as investors
—creditors as lenders
—customers as purchasers



How do those who finance the business benefit?

—owners get return on investment
—creditors get interest
—customers get goods and services

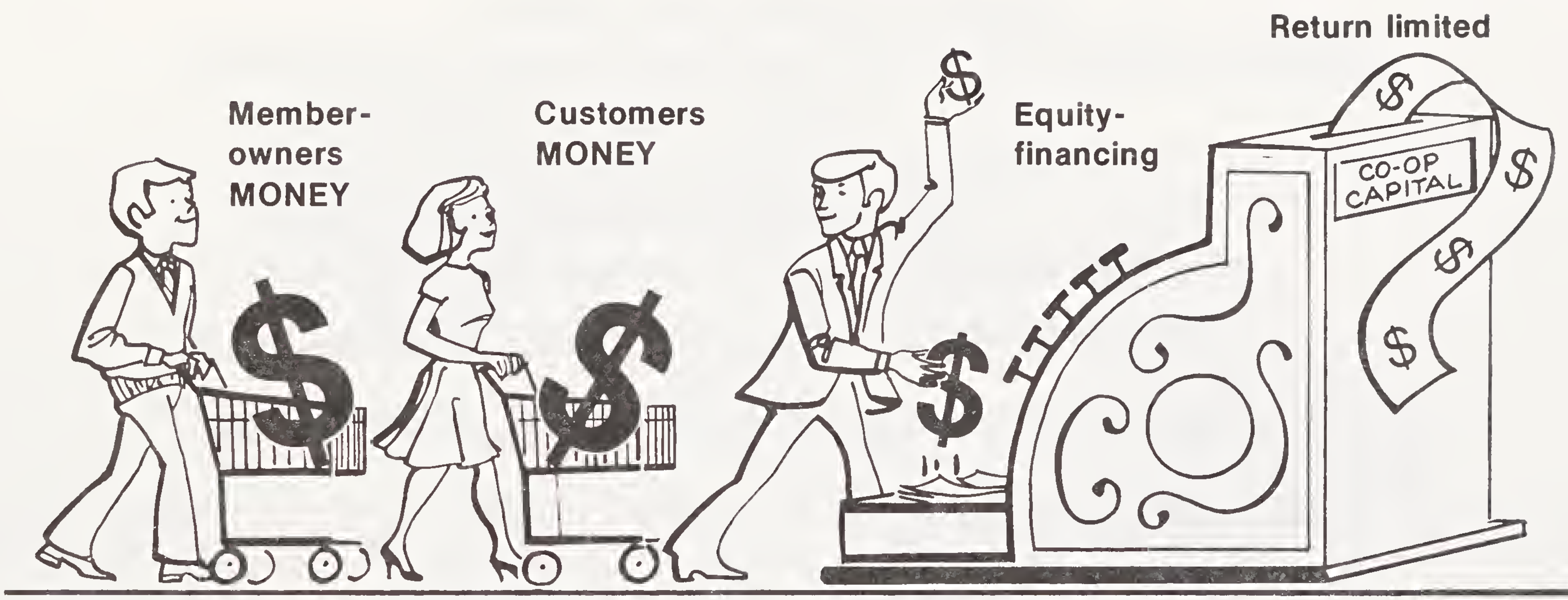


How does cooperative financing differ?

Purchasing and service cooperatives:

- —owners and patrons are essentially the same
- —equity-financing sources limited
- —return on member capital is limited
- —no speculative stock trading

Conclusion: Member-owners bear substantially greater burden for providing capital.



How does cooperative financing differ?

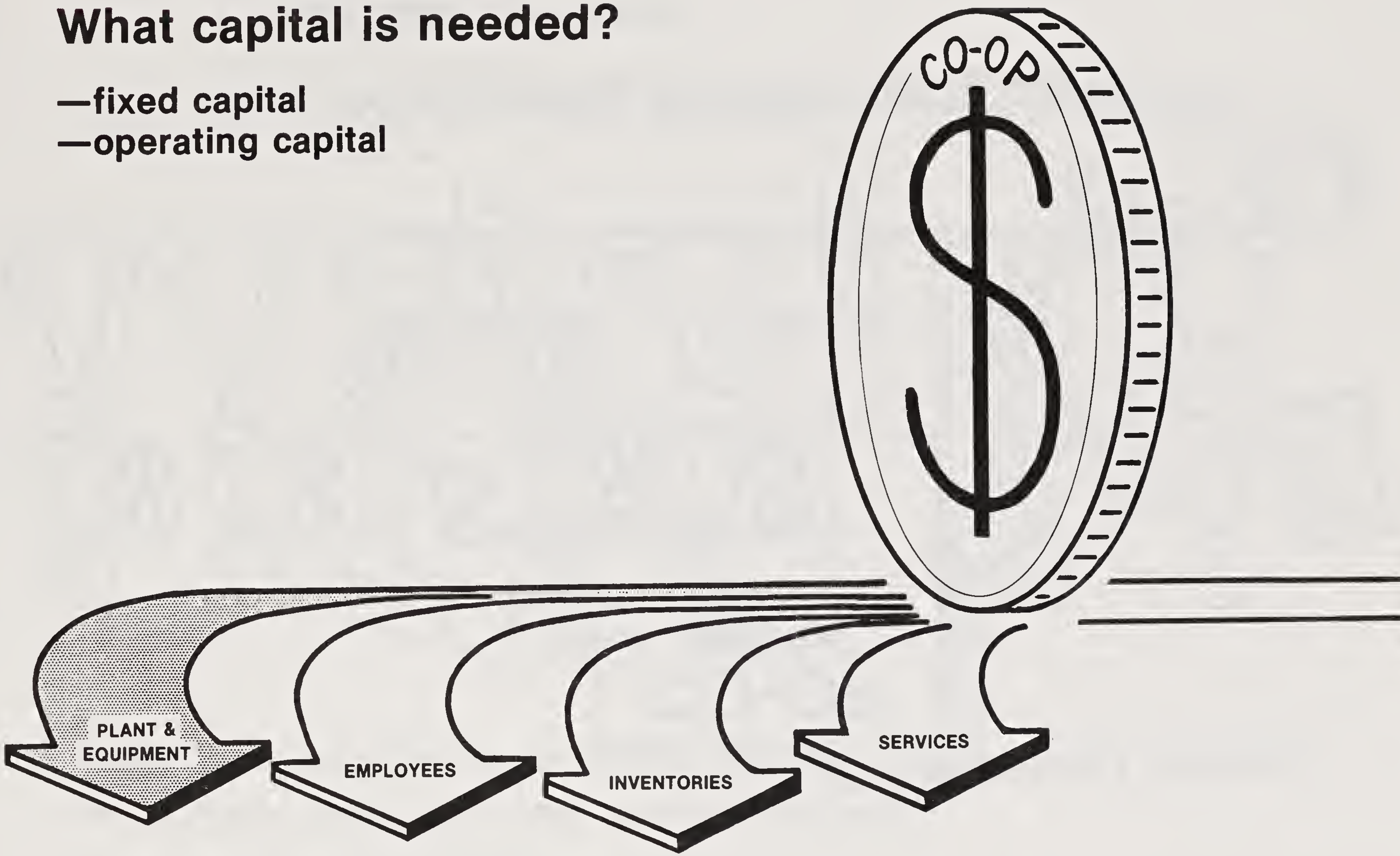
Marketing cooperative:

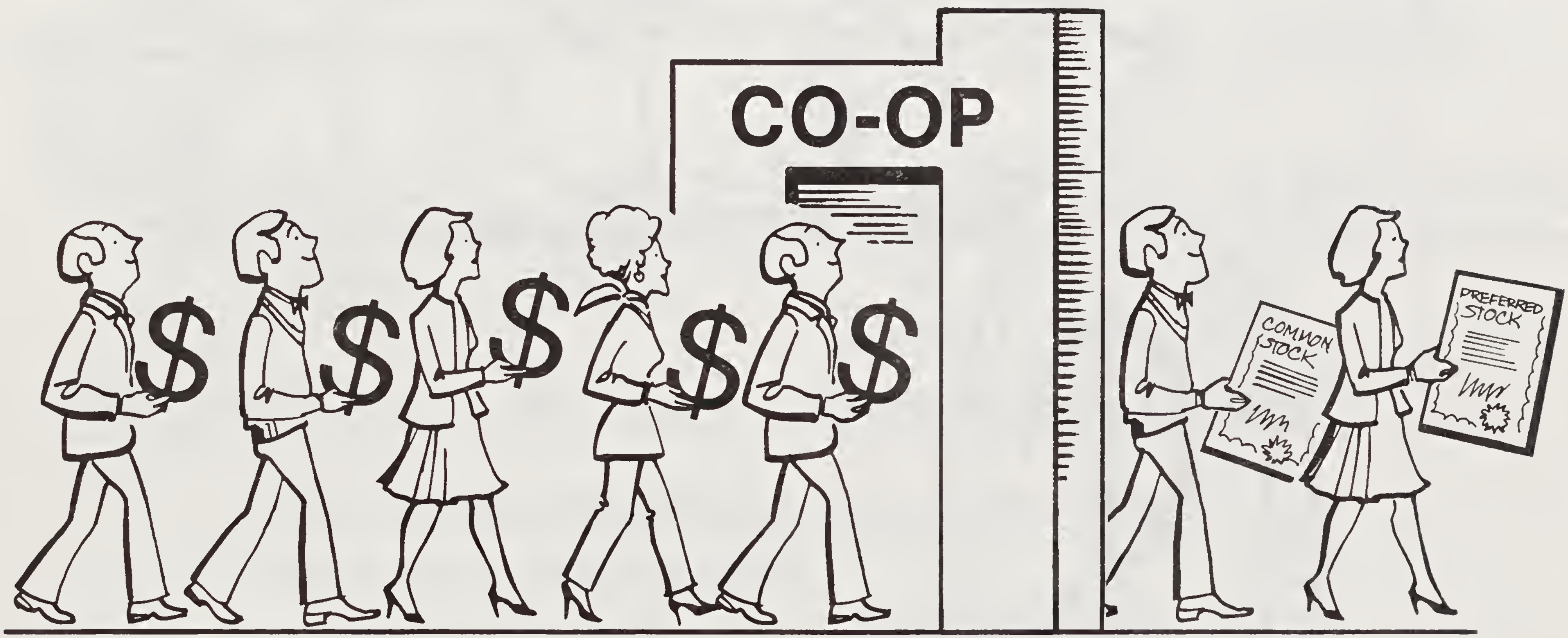
—owners and patrons are essentially the same
—equity-financing sources limited
—customers who buy farmer-members' products (indirectly, as for any business)
—return on member capital is limited
—no speculative stock trading

Conclusion: Member-owners bear substantially greater burden for providing capital.

What capital is needed?

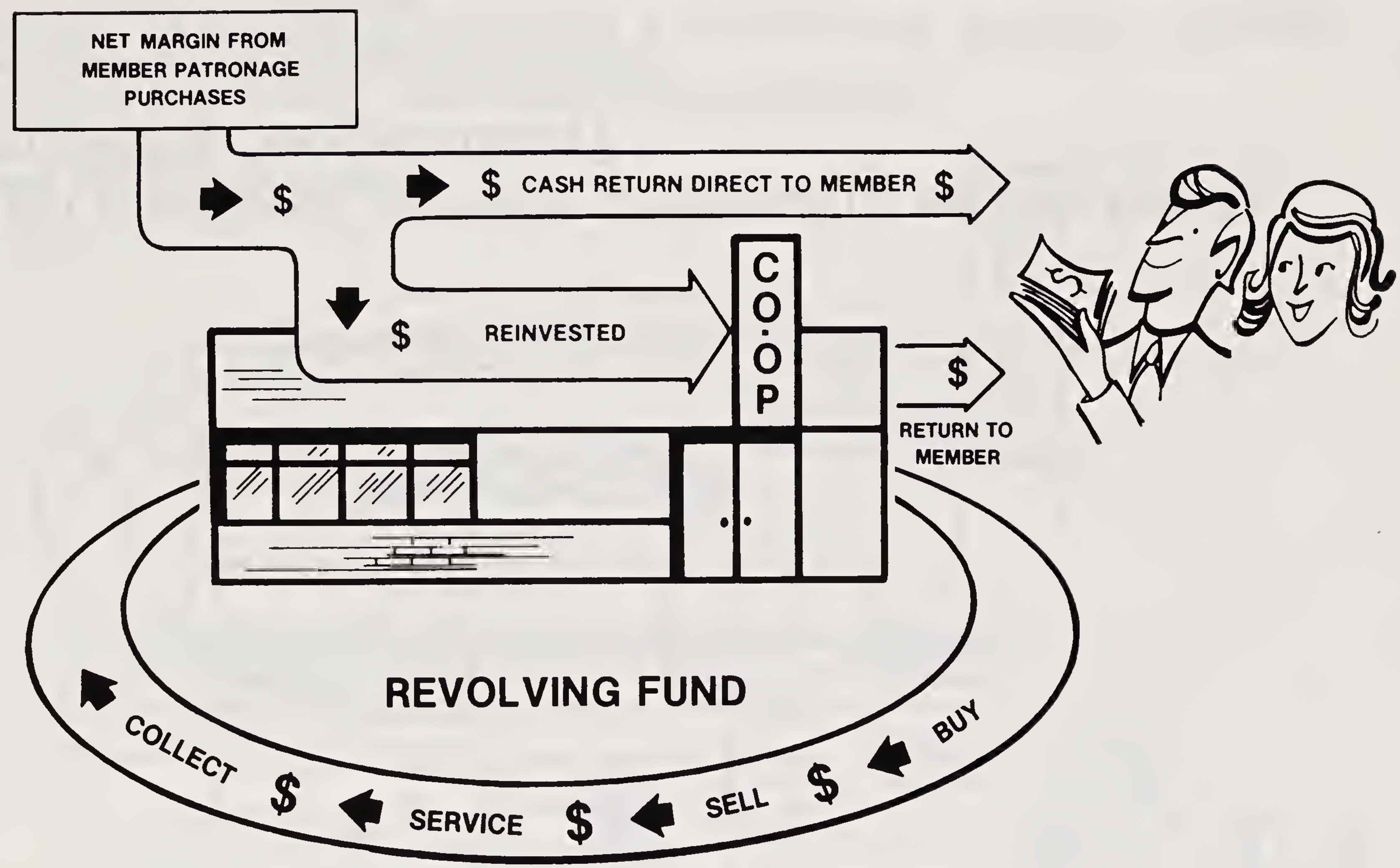
—fixed capital
—operating capital





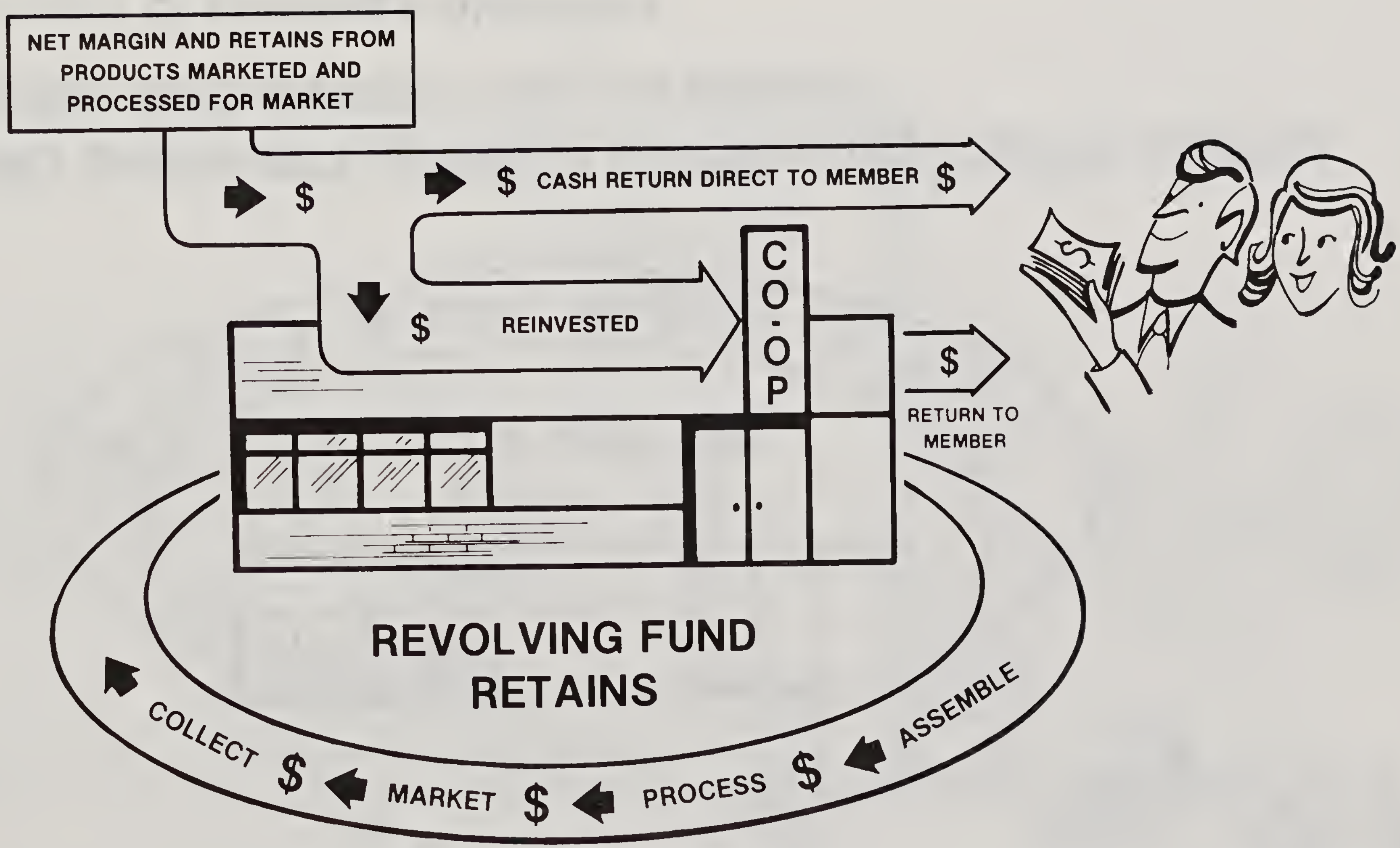
How do members provide equity capital?

—initial capital investment



How do members provide continuing equity capital in supply and service cooperatives?

—investment of patronage allocations

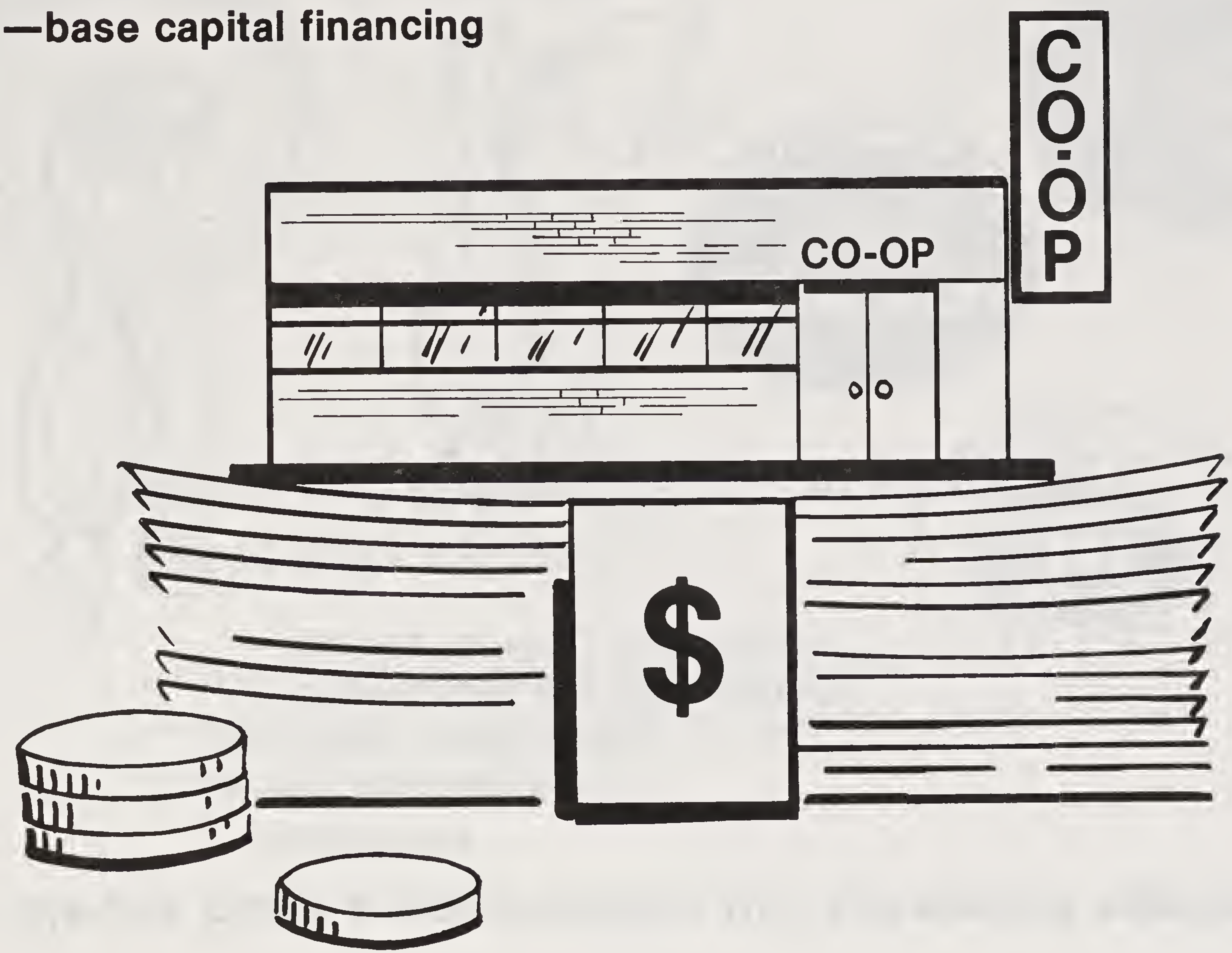


How do members provide continuing equity capital in marketing cooperatives?

—investment of patronage allocations
—per unit retain financing

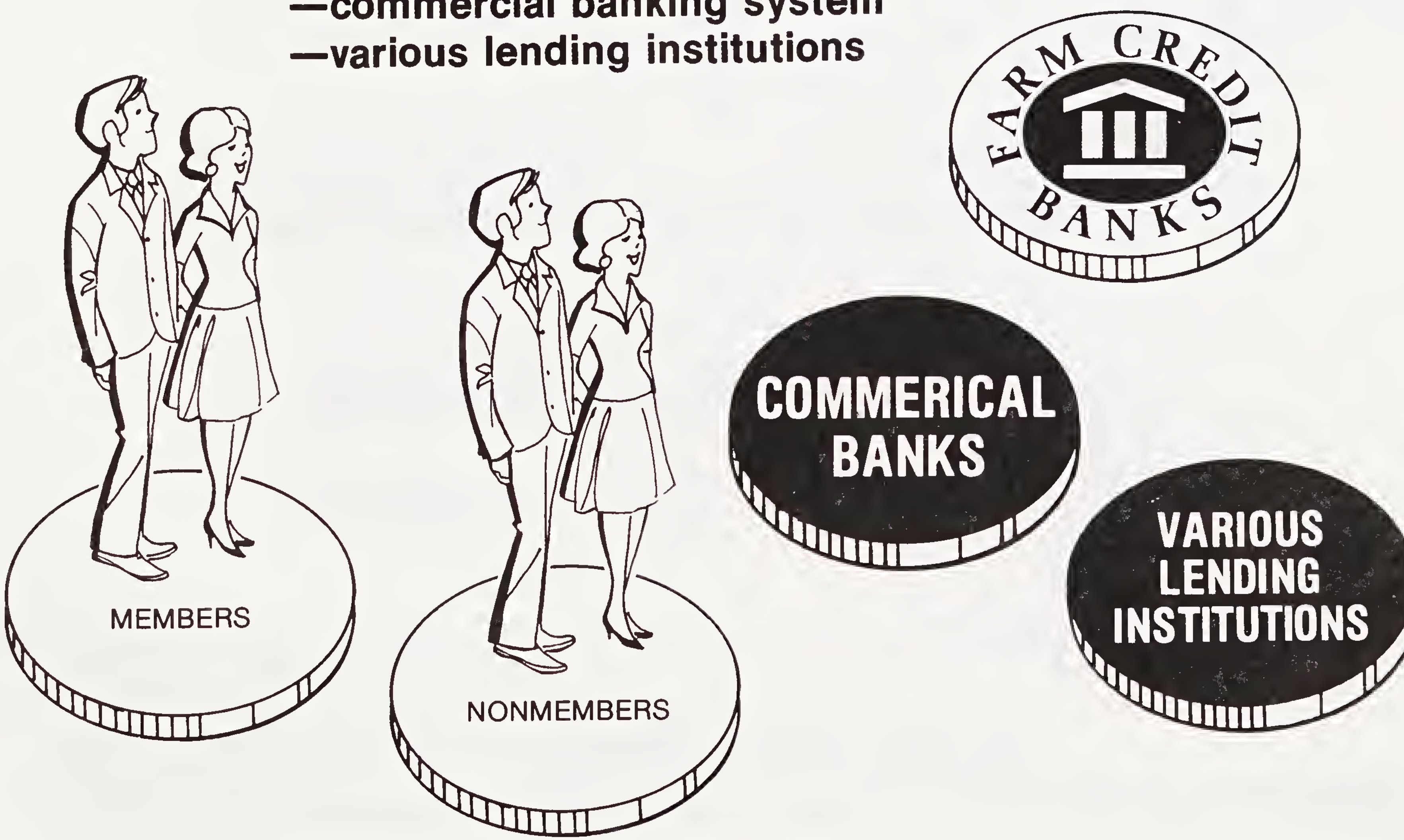
How do members provide continuing equity capital on a permanent, nonrevolving basis?

—base capital financing



Where does a cooperative get borrowed capital?

—members
—nonmembers
—Farm Credit Banks
—commercial banking system
—various lending institutions

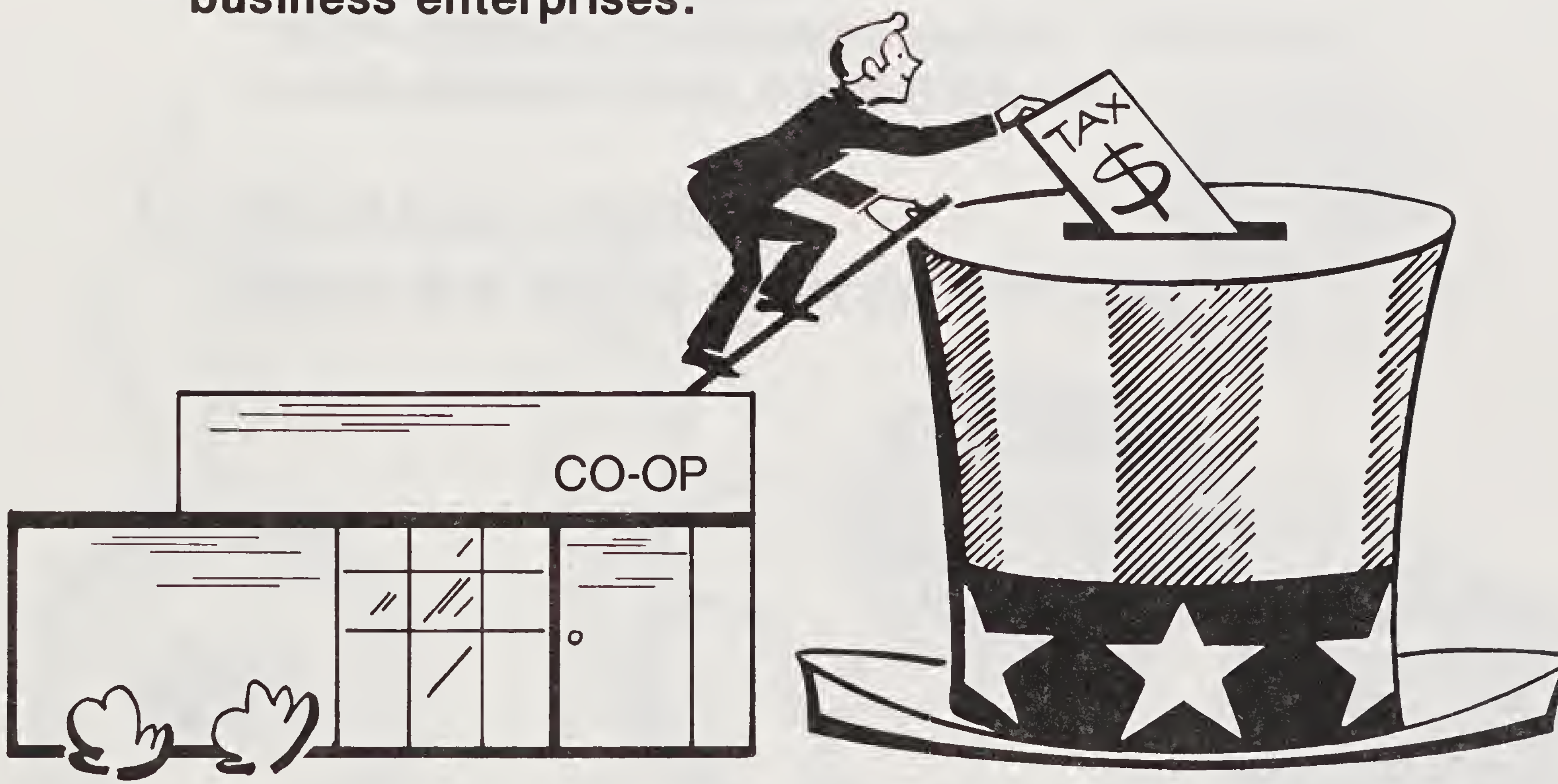


What are some special sources of borrowed capital?

—Rural Electrification Administration
—Rural Utilities Cooperative Finance Corporation
—Rural Telephone Bank

How do tax regulations apply to cooperatives?

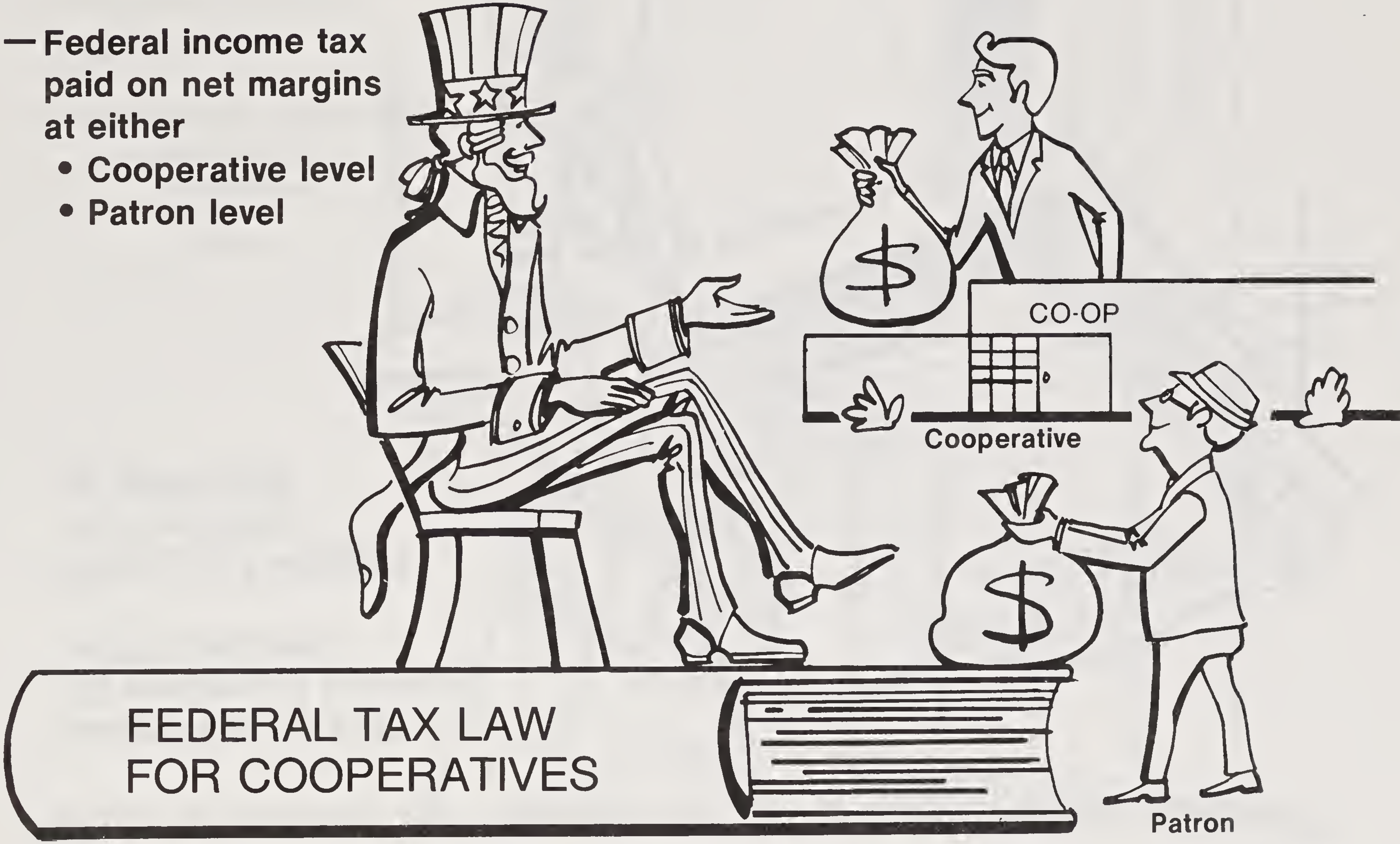
—subject to most taxes on the same basis as other business enterprises:



- Sales
- Payroll
- Franchise and license
- Gasoline
- Real estate
- Personal property
- Excise
- State and federal income

What is the principle of Federal tax law for any firm operating on a cooperative basis?

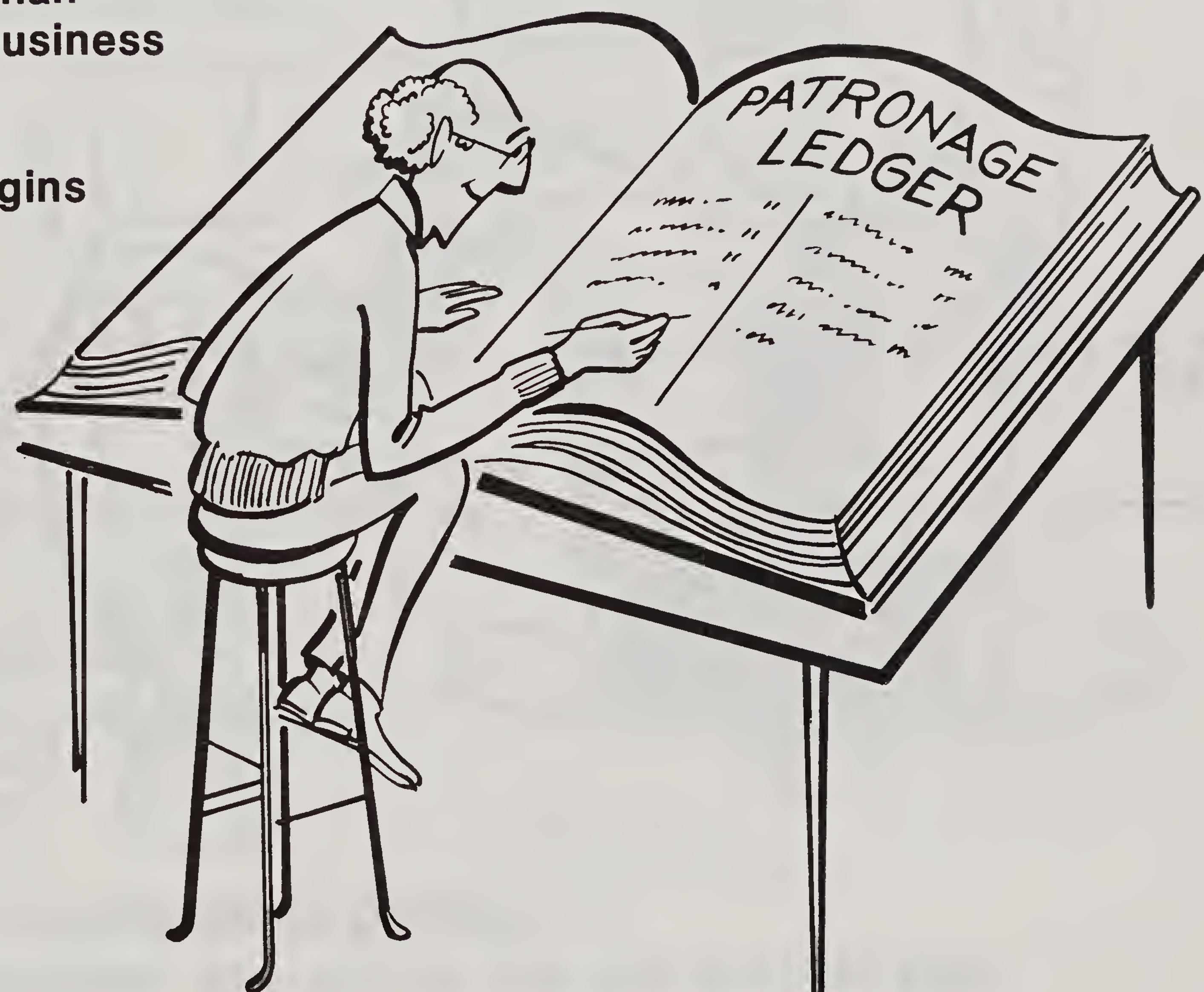
— Federal income tax paid on net margins at either
  - Cooperative level
  - Patron level



What is meant by "operating on a cooperative basis?"

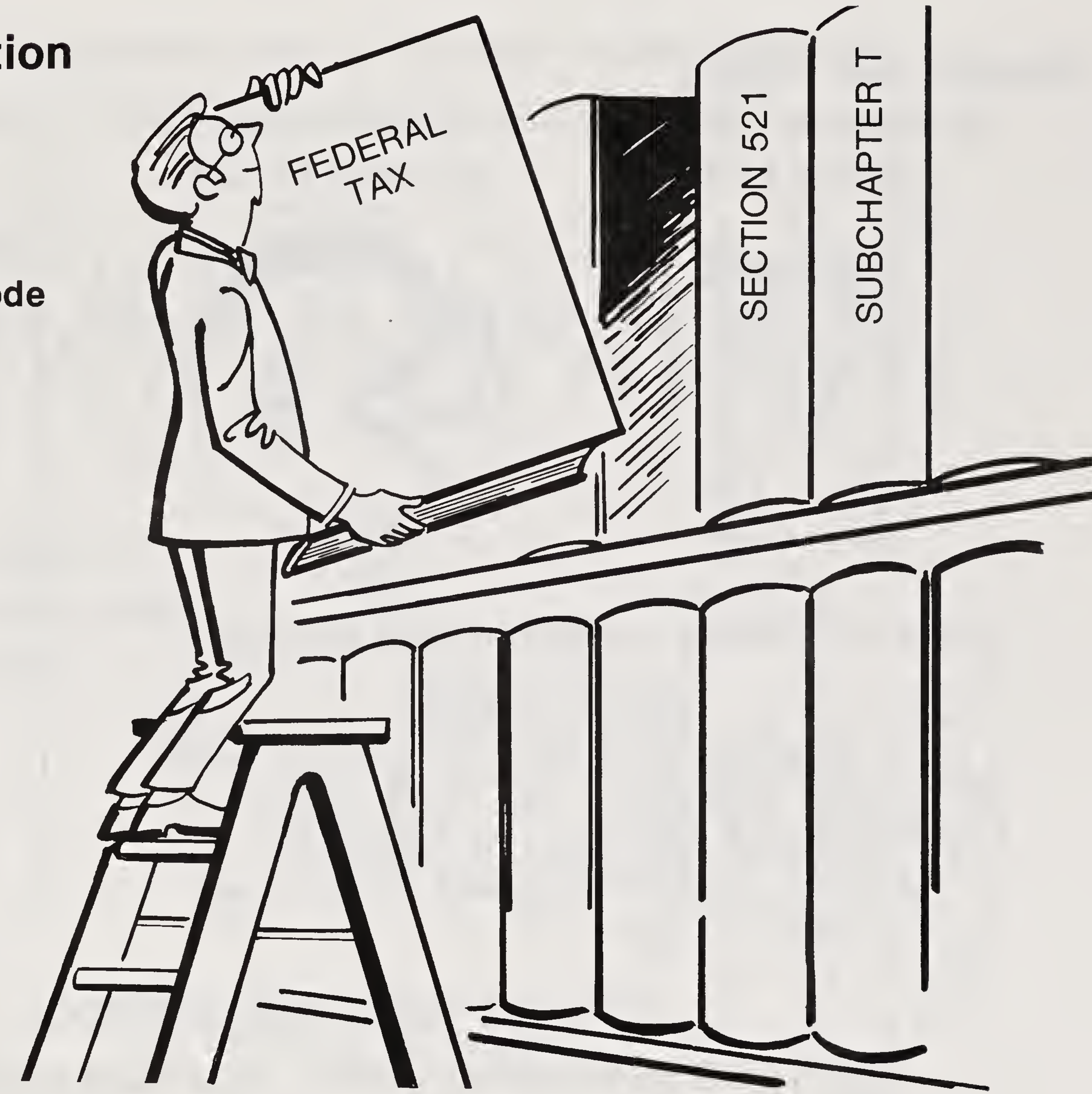
—conduct more than
50 percent of business
with members

—refund net margins
in proportion
to patronage

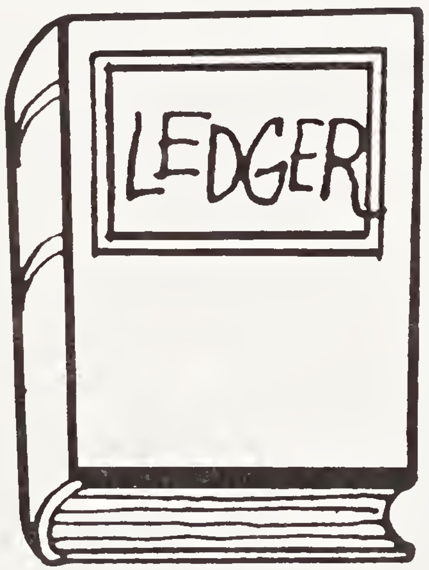


Where is information describing cooperative tax treatment?

—subchapter T, IRS Code
- —alternatives:
  - nonexempt
  - and
  - exempt



What requirements must businesses fulfill to have "cooperative" tax status?



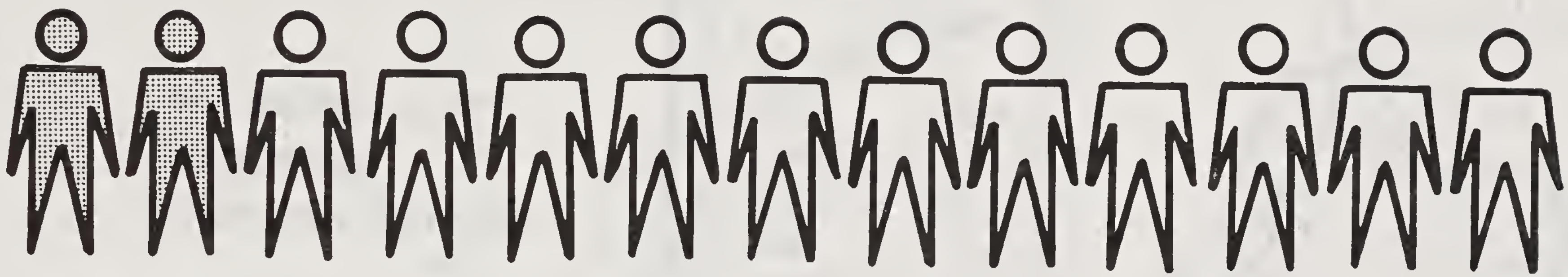
—maintain permanent:
- —patronage records
- —equity interest records of members

—allocate net margin on patronage basis

—pay at least 20 percent cash

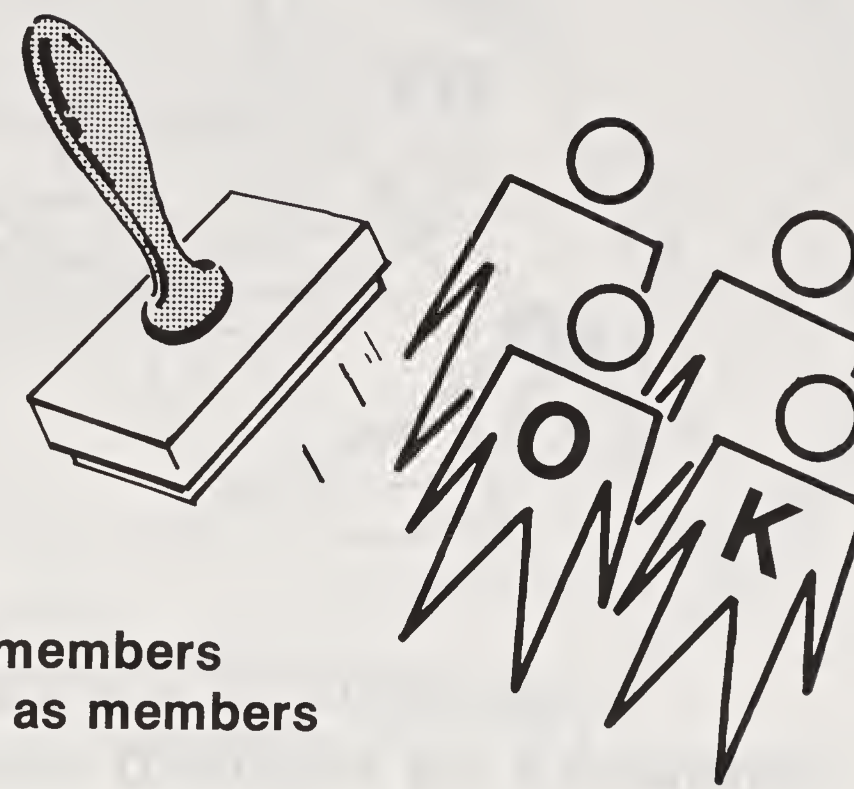
—pay within 8½ months of fiscal year closing

What requirements can a farmer cooperative fulfill to gain "limited" tax exemptions?



15%

—not exceed 15 percent of business with persons who are neither members nor producers

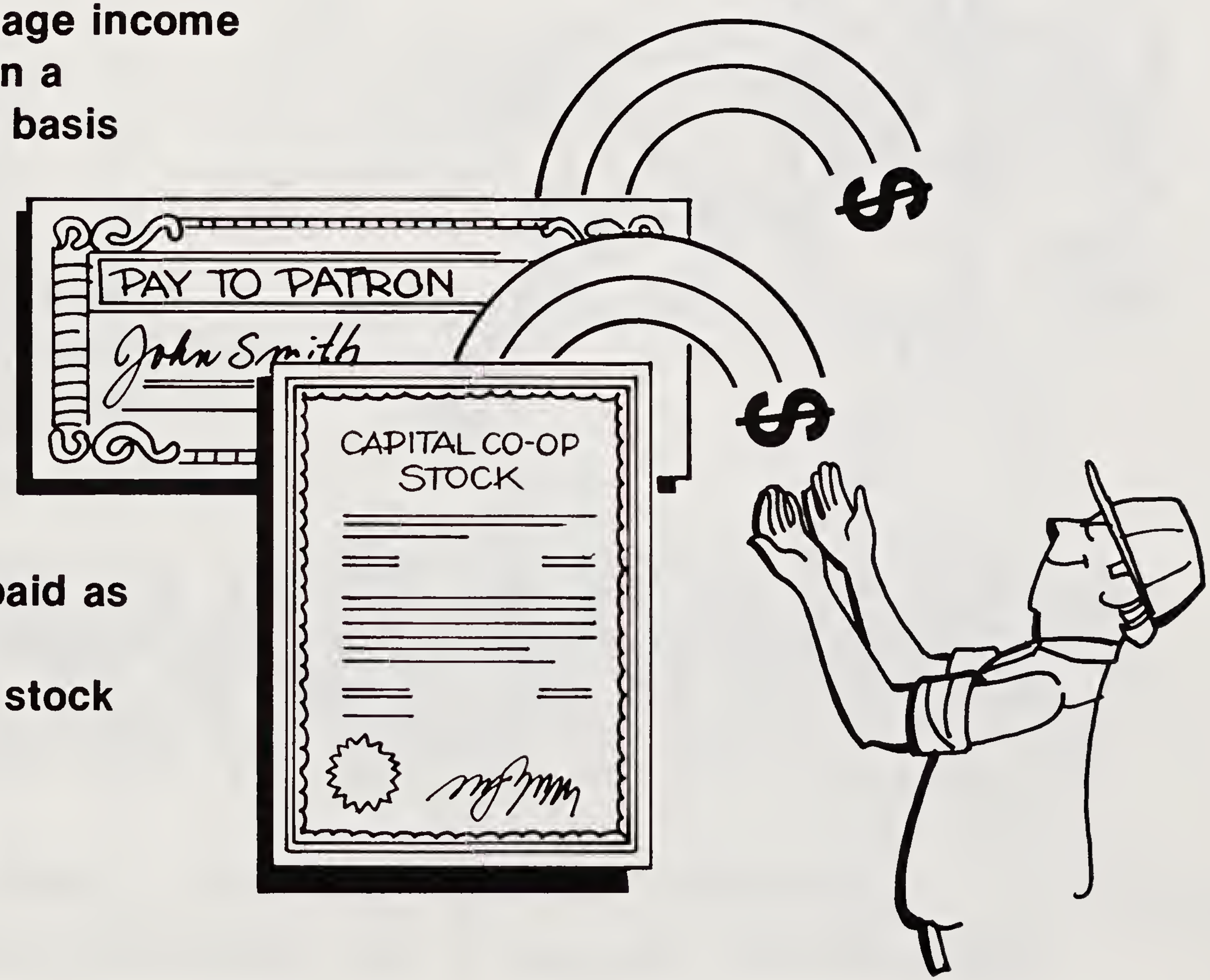


—treat nonmembers the same as members

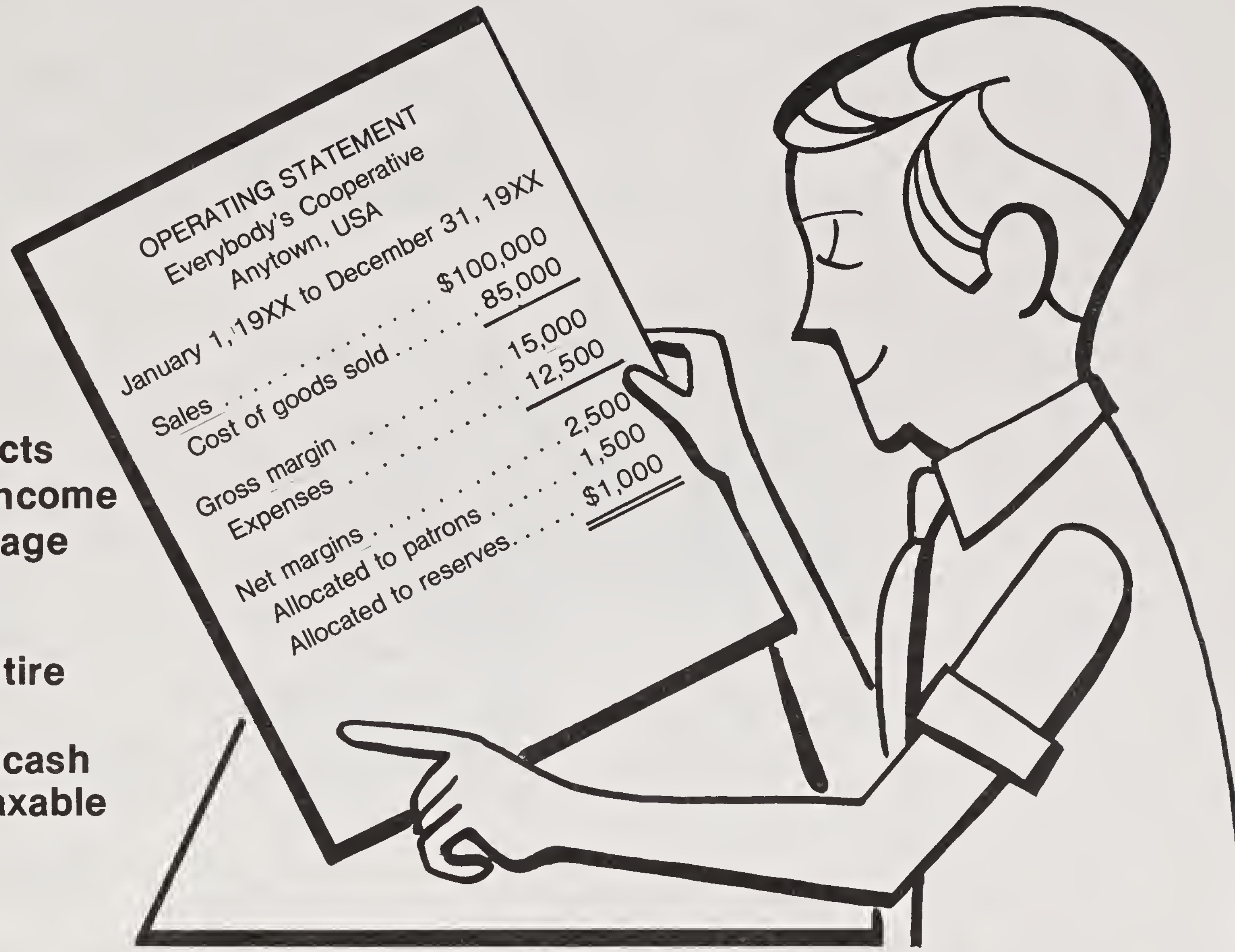
When a farmer cooperative qualifies for exemption what other tax deductions are permitted?

—amounts of nonpatronage income paid out on a patronage basis

—amounts paid as dividends on capital stock

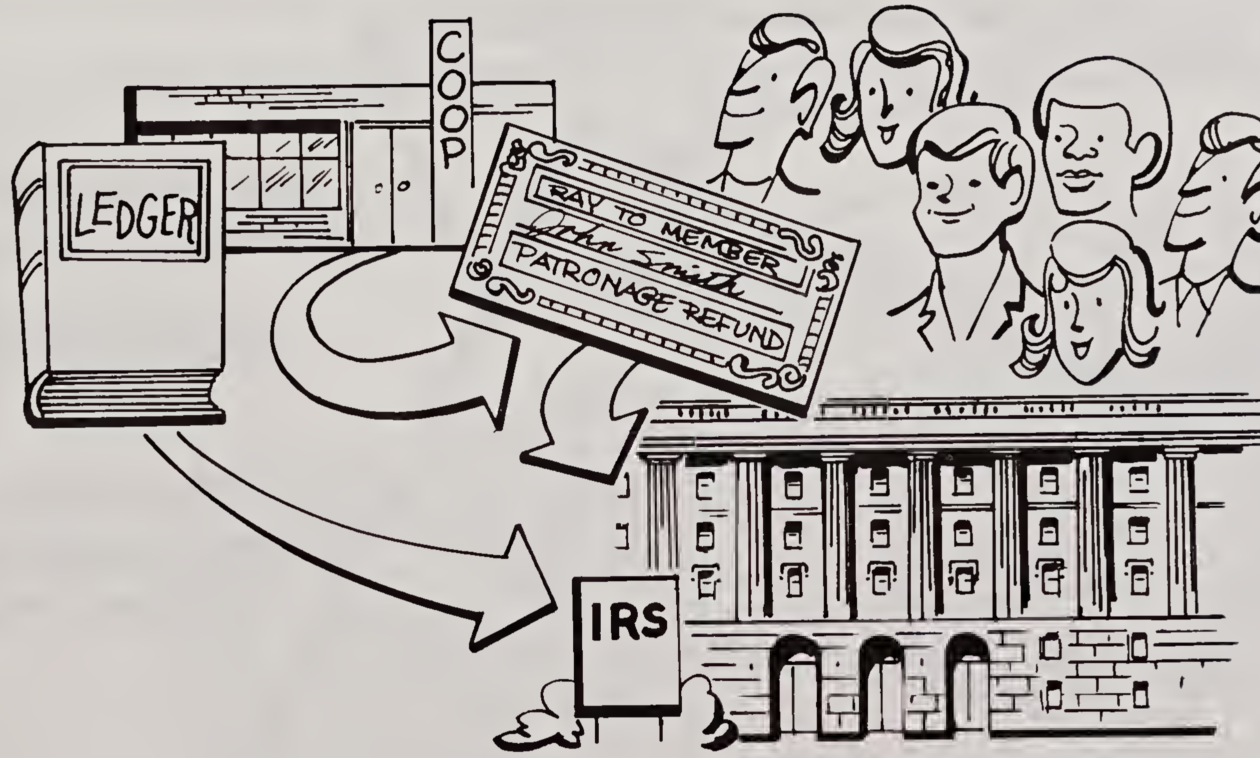


What reporting procedures must a cooperative and its member-patrons follow concerning the tax treatment of patronage refunds?



—cooperative deducts from its taxable income amount of patronage refund.

—patron reports entire refund
  —cash and noncash as ordinary taxable income



Summary

—member-owners bear greater burden for financing cooperative than do owners of other corporate business

—cooperatives must meet IRS requirements

—IRS code provides farmer cooperatives alternate methods of handling net margins

—either cooperative or member-patron assumes income tax liability

—cooperatives pay other taxes on the same basis as other businesses

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COOPERATIVE PROGRAM

U.S. Department of Agriculture
Economics, Statistics, and Cooperatives Service

The Cooperative Program of ESCS provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

The Program (1) helps farmers and other rural residents obtain supplies and services at lower cost and to get better prices for products they sell; (2) advises rural residents on developing existing resources through cooperative action to enhance rural living; (3) helps cooperatives improve services and operating efficiency; (4) informs members, directors, employees, and the public on how cooperatives work and benefit their members and their communities; and (5) encourages international cooperative programs.

The Program publishes research and education materials and issues *Farmer Cooperatives.* All programs and activities are conducted on a nondiscriminatory basis, without regard to race, creed, color, sex, or national origin.